City of Lafayette Staff Report

For:	City Council
By:	Malathy Subramanian
	Niroop K. Srivatsa
Date Written:	November 4, 2008
Meeting Date:	November 10, 2008
Subject:	**Lafayette Residential Partner's Request to Transfer the Phase III Property and the Town Center Development Agreement to KB Home South Bay, Inc.**

This matter was on the October 27th agenda but was not considered at Lafayette Residential Partners' (LRP) request. LRP is now requesting that the matter be considered on November 10th. The October 27th staff report is attached.

Recommendation

Adopt Resolution 2008-047 approving Lafayette Residential Partner's request to transfer the Phase III property and the Town Center Development Agreement to KB Home South Bay, Inc.; the transfer to become effective upon: (1) KB Home's execution of an assignment and assumption agreement in a form approved by the City; and (2) the transfer of the Property to KB Home prior to the expiration of the Development Agreement.

8B2

City of Lafayette Staff Report

For:	City Council
By:	Malathy Subramanian
	Niroop K. Srivatsa
Date Written:	October 20, 2008
Meeting Date:	October 27, 2008
Subject:	**Lafayette Residential Partner's Request to Transfer the Phase III Property and the Town Center Development Agreement to KB Home South Bay, Inc.**

Background

On October 6, 2008, the City received a letter from Lafayette Residential Partners LLC requesting the City's written consent to the transfer of certain real property located adjacent to Mt. Diablo Boulevard and South Thompson Road, within the City of Lafayette ("Property") and the assignment of LRP's interest in the Town Center Development Agreement ("Development Agreement") to KB Home South Bay, Inc. ("KB Home"). Pursuant to the Development Agreement, the City is required to act on the request within thirty days or consent is considered approved.

Per Section 7.06(a) of the Development Agreement, the City is required to consider the following four standards in responding to a request for transfer of the Property and the Development Agreement:

(1) Business experience, good reputation, and financial resources (or access to financial resources necessary to complete the Project;

(2) The transferee must enter into a written assumption agreement in recordable form, approved by the City, assuming and agreeing to be bound by the Agreement;

(3) The transfer will not cause a substantial delay in the Project; and

(4) Developer is not in material breach with respect to its obligations under the Agreement.

With respect to the first standard, KB Home is a Fortune 500 company and one of the country's largest homebuilders. The company has operated in the Bay Area since 1967. Formerly known as Kaufman and Broad, KB Home is primarily a single family builder with projects in California, Arizona, Nevada, New Mexico, Colorado, Texas and Florida. The company has entered the multi family market and has built high density projects in San Jose, Fremont and Milpitas. Attached for the City Council's consideration is a packet of information submitted by KB Home, including sections from the company's 2007 Annual Report. The full report is available at the city offices.

Regarding the second standard, both LRP and KB are aware of the requirement that KB must enter into a written assumption agreement with the City agreeing to be bound by the Development Agreement. The Development Agreement will expire on May 27, 2010.

With respect to the third standard, KB Home will be required to comply with the timeframe to complete the Project as specified in the Development Agreement. Additionally, LRP's attorney has furnished a tentative schedule for Project construction. With respect to the fourth standard, staff is not aware of a material breach of the Development Agreement by LRP.

Staff recommends that the City Council approve the transfer of the Property and the Development Agreement to KB Home to become effective upon: (1) KB Home's execution of an assignment and assumption agreement in a form approved by the City; and (2) the transfer of the Property to KB Home prior to the expiration of the Development Agreement.

Recommendation

Adopt Resolution 2008-044 approving Lafayette Residential Partner's request to transfer the Phase III property and the Town Center Development Agreement to KB Home South Bay, Inc.; the transfer to become effective upon: (1) KB Home's execution of an assignment and assumption agreement in a form approved by the City; and (2) the transfer of the Property to KB Home prior to the expiration of the Development Agreement.

Attachments

1. Resolution 2008-044
2. Letter from David Bowie, LRP's attorney dated October 6, 2008 requesting the transfer
3. Letter from David Bowie, LRP's attorney dated October 20, 2008 providing a project schedule
4. Signed Memorandum of Agreement between LRP and KB Home
5. 2008 Amended and Restated Settlement Agreement
6. Materials from KB Home, Inc.

BEFORE THE CITY COUNCIL OF THE CITY OF LAFAYETTE

IN THE MATTER OF:

A Resolution of the City Council of the City of Lafayette Approving Lafayette Residential Partner's Request to Transfer the Phase III Property and the Town Center Development Agreement to KB Home South Bay, Inc. Effective Upon an Amendment to the Development Agreement	Resolution 2008-047

WHEREAS, Lafayette Residential Partners LLC ("LRP") has entered into a contract to sell certain real property located adjacent to Mt. Diablo Boulevard and South Thompson Road, within the City of Lafayette ("Property") to KB Home South Bay, Inc. ("KB Home");

WHEREAS, KB Home has a conditioned equitable interest in the Property and will not have an equitable interest in the Property, if and until the Property has received all approvals for the residential Project, as hereinafter defined.

WHEREAS, LRP has requesting the City's written consent for the transfer of the Property and assignment of LRP's interest in the Town Center Development Agreement ("Development Agreement") to KB Home;

WHEREAS, the Development Agreement provided for the phased construction of three components, which included residential, retail and office uses;

WHEREAS, the remaining project component to be constructed under the Development Agreement is an office use or a residential project that is an alternative to the office use ("Project");

WHEREAS, KB Home has expressed to the City an interest to build the Project with the residential alternative;

WHEREAS, KB Home has presented its business experience, good reputation, and financial resources (or access to financial resources) necessary to complete the Project;

WHEREAS, KB Home has confirmed that it will comply with the timeframe to complete the Project as specified in the Development Agreement;

WHEREAS, Government Code section 65865 provides that a city may enter into a development agreement with any person having a legal or equitable interest in real property for the development of property; and

WHEREAS, the City is willing to consider the transfer of the Property and the Development Agreement to KB Home to become effective upon: (1) KB Home's execution of an assignment and assumption agreement in a form approved by the City; and (2) the transfer of the Property to KB Home prior to the expiration of the Development Agreement.

NOW THEREFORE BE IT RESOLVED THAT:

Section 1. Findings Related to Conditions and Standards for Consent to Transfer of the Property and the Development Agreement. The City Council of the City of Lafayette ("City Council") has considered the conditions and standards set forth in Section 7.06 of the Development Agreement, and all written and oral evidence presented to the City Council, and hereby makes and adopts the following findings: (a) KB Home desires to complete the Project and has presented evidence related to its business experience, good reputation, and financial resources (or access to financial resources) necessary to complete the Project; (b) KB Home desires to expeditiously complete the Project in compliance with the timeline as provided for in the Development Agreement

and will not cause a substantial delay in the Project; and (c) LRP is not in material breach with respect to its obligations under the Development Agreement.

Section 2. Approval of the Transfer of the Property and the Development Agreement to KB Home Effective Upon Certain Conditions. The City Council hereby approves LRP's request to transfer the Property and its interest in the Development Agreement to KB Home to become effective upon: (a) KB Home's execution of an assumption agreement in recordable form approved by the City, assuming and agreeing to be bound by the Development Agreement; and (b) the transfer of the Property to KB Home prior to the expiration of the Development Agreement. If the following conditions are not met prior to the expiration of the Development Agreement, then the City Council's approval of LRP's request to transfer the Property and its interest in the Development Agreement to KB Home shall no longer be valid. This Resolution does not bind the City Council to amend the Development Agreement or approve a new development agreement.

Section 3. Effective Date. This Resolution shall become effective upon its adoption.

PASSED AND ADOPTED by the City Council at a regular meeting of said Council on November 10, 2008, by the following vote:

AYES:
NOES:
ABSENT:
ABSTAIN:

ATTEST:

Joanne Robbins, City Clerk

APPROVED:

Mike Anderson, Mayor

LAW OFFICE OF DAVID J. BOWIE
Attorney at Law
2255 CONTRA COSTA BLVD., SUITE 305
PLEASANT HILL, CA 94523

DAVID J. BOWIE

Telephone (925) 939-5300
Facsimile (925) 609-9670
Dave@bblandlaw.com

October 20, 2008

Niroop Srivatsa
City of Lafayette
3675 Mt. Diablo Blvd, Suite 210
P.O. Box 1968
Lafayette, CA 94549

Malathy Subramanian
Best, Best & Krieger, LLP
2033 N. Main Street, Suite 750
Walnut Creek, CA 94596

Re: Lafayette Town Center

Dear Niroop and Mala:

I was asked to comment regarding the development timeline anticipated with respect to Phase III of Lafayette Town Center in the context of the pending Assignment of Development Agreement and transfer of the related land to KB Home South Bay Inc. I must say that there is absolutely no basis from which it might be concluded that Lafayette Residential Partners, LLP, as current owner, would complete a development in less time than would occur in the event of transfer to KB Home. In other words, the issue of whether or not the proposed transfer would cause substantial delay is one which can only be answered in the negative. Nonetheless, the following timeline would appear to be realistic depending largely upon the City's compliance with the both the spirit and intent of the process provisions of the Development Agreement as amended:

1. Approximately 90 days will be required to upgrade architectural drawings for submittal to a joint meeting.
2. Approvals with all entitlements should be in hand during calendar year 2009.

3. Construction can commence within approximately 4 months of entitlements based on anticipated completion of construction drawings and plan check. Construction should commence during late 2009-early 2010.
4. Units should be available for delivery approximately 12 months thereafter.

Much of the above timeline is depended upon City and/or County Building Inspection Department actions and, therefore, must be deemed subject to change. I do not see any "substantial" delay in the process occasioned by the proposed transfer.

Very truly yours,

David J. Bowie

Cc: Rick Dishnica

LAW OFFICE OF DAVID J. BOWIE
Attorney at Law
2255 CONTRA COSTA BLVD., SUITE 305
PLEASANT HILL, CA 94523

RECEIVED
OCT 6 2008
CITY OF LAFAYETTE

DAVID J. BOWIE

Telephone (925) 939-5300
Facsimile (925) 609-9670
Dave@bblandlaw.com

JRobbins@lovelafayette.org

October 6, 2008

Mayor Mike Anderson
And Members of the Lafayette City Council
c/o Joanne Robbins, City Clerk
City of Lafayette
3675 Mt. Diablo Blvd., Suite 210
Lafayette, CA 94549

Re: Lafayette Town Center Project and Consent to Transfer to KB Home

Dear Mayor Anderson and Members of the City Council:

As you are all aware, I represent Lafayette Residential Partners, LLC, a Delaware Limited Liability Company. (LRP). I am pleased to confirm that LRP, as seller, has entered into an Agreement for Purchase and Sale of Real Property with KB Home South Bay Inc., a California Corporation, as buyer. The Property which is the subject of that Agreement is the residential for-sale condominium building described in the Lafayette Town Center Phase III Option 5 Concept Plans prepared by Heller-Manus Architects.

Pursuant to Section 7.06 of the Development Agreement between the City of Lafayette and Lafayette Town Center Associates (to which LRP has succeeded), the assignment of that Development Agreement or transfer of the LRP interest in the subject real property cannot be completed without the prior written consent of the City. My purpose in writing to you is to request that written consent and to advise that the City's failure to act upon such request within 30 days shall be deemed to be the approval thereof.

KB Home South Bay Inc., was previously a designated assignee of LRP rights under the Development Agreement and transferee of the same real property interests. At the time of the prior request for consent to transfer, extensive materials were submitted for consideration by this Council and, by Resolution, KB Home was deemed to be an acceptable assignee and transferee. While that prior approval would suggest the absence of any reasonable basis for withholding consent to the presently pending request, KB Home has nonetheless resubmitted updated

materials as a part of this request for transfer and assignment. Obviously, KB Home has the business experience, good reputation, and financial resources sufficient to undertake and complete the contemplated project. Please note that the proposed transfer will not cause a substantial delay in the project and LRP is not in any material breach of its obligations under the Agreement. Finally, pursuant to the Settlement Agreement previously concluded between LRP and the City and the more recent Amendments to the Development Agreement, the request for consent to assignment and transfer herein contained should be granted.

Pursuant to my discussions with Joanne Robbins, I understand this matter will be considered by the Council at its October 13 hearing. I will be present at that hearing with representatives of both LRP and KB Home to respond to any questions or matters which might arise.

Thank you for your consideration of this matter and your cooperation in effecting a consent to assignment and transfer as herein described.

Very truly yours,

David J. Bowie

Cc: LRP
KB Home
Malathy Subramanian

MEMORANDUM OF AGREEMENT

THIS MEMORANDUM OF AGREEMENT has been made and entered into effective as of August 26, 2008 by and between Lafayette Residential Partners, LLC, a Delaware Limited Liability Company (Seller) and KB Home South Bay Inc., a California Corporation (Buyer).

RECITALS

A. Seller is the Owner of a certain parcel of unimproved real property consisting of approximately 1.47 acres and commonly known as Phase III, Lafayette Town Center. (Property). Seller is also the successor in interest to Lafayette Town Center Associates as Developer by and under the terms of a certain Development Agreement between the City of Lafayette and Lafayette Town Center Associates, a California Limited Partnership, dated June 1, 1998.

B. Buyer is an accomplished developer and builder of residential housing units. Buyer wishes to purchase from Seller all of its right, title, and interest in and to the Property.

C. The parties wish by this Memorandum to confirm their respective positions as Seller/Owner of the Property and prospective Buyer thereof.

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. Seller and Buyer have together executed a certain Agreement for Purchase and Sale of Real Property and Escrow Instructions effective as of August 26, 2008. (Purchase Agreement). The real property subject to said Agreement is Phase III as described in the Development Agreement pertaining to Lafayette Town Center. The Assessor's Parcel Number of the real property subject to said Agreement is APN 243-040-035.

2. This Memorandum of Agreement has been provided for the sole purpose of giving notice and confirming the existence of a valid Purchase Agreement between the parties. In the event of any conflict between this Memorandum and the Purchase Agreement, the Purchase Agreement shall prevail.

3. By this Memorandum, the parties hereby acknowledge that Seller is the Owner of the subject real property and that Buyer has a conditional equitable interest therein subject to the terms of the Purchase Agreement.

IN WITNESS WHEREOF, the parties hereby execute this Memorandum effective as of the date set forth above.

Lafayette Residential Partners, LLC,
a Delaware Limited Liability Company

By:_____

KB Home South Bay Inc.,
a California Corporation

By: _____

MEMORANDUM OF AGREEMENT

THIS MEMORANDUM OF AGREEMENT has been made and entered into effective as of August 26, 2008 by and between Lafayette Residential Partners, LLC, a Delaware Limited Liability Company (Seller) and KB Home South Bay Inc., a California Corporation (Buyer).

RECITALS

A. Seller is the Owner of a certain parcel of unimproved real property consisting of approximately 1.47 acres and commonly known as Phase III, Lafayette Town Center. (Property). Seller is also the successor in interest to Lafayette Town Center Associates as Developer by and under the terms of a certain Development Agreement between the City of Lafayette and Lafayette Town Center Associates, a California Limited Partnership, dated June 1, 1998.

B. Buyer is an accomplished developer and builder of residential housing units. Buyer wishes to purchase from Seller all of its right, title, and interest in and to the Property.

C. The parties wish by this Memorandum to confirm their respective positions as Seller/Owner of the Property and prospective Buyer thereof.

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. Seller and Buyer have together executed a certain Agreement for Purchase and Sale of Real Property and Escrow Instructions effective as of August 26, 2008. (Purchase Agreement). The real property subject to said Agreement is Phase III as described in the Development Agreement pertaining to Lafayette Town Center. The Assessor's Parcel Number of the real property subject to said Agreement is APN 243-040-035.

2. The parties hereby incorporate by reference each and all of the provisions of the aforesaid Purchase Agreement in this Memorandum. Specific reference is made to said Purchase Agreement and each and every provision of this Memorandum is expressly subject to and conditioned by the terms and provisions of that Purchase Agreement.

3. By this Memorandum, the parties hereby acknowledge that Seller is the Owner of the subject real property and that Buyer has a conditional equitable interest therein as specifically defined by and subject to the terms of the Purchase Agreement.

IN WITNESS WHEREOF, the parties hereby execute this Memorandum effective as of the date set forth above.

Lafayette Residential Partners, LLC,
a Delaware Limited Liability Company

By: Richard Dunheen
Richard Dunheen, Member

KB Home South Bay Inc.,
a California Corporation

By: _____

AMENDED AND RESTATED SETTLEMENT AGREEMENT

THIS AMENDED AND RESTATED SETTLEMENT AGREEMENT, (Restated Settlement Agreement) is made as of this 25 day of February, 2008; (the effective date) by and between the City of Lafayette, a California Municipal Corporation (Lafayette) and Lafayette Residential Partners, LLC, a Delaware Limited Liability Company (LRP).

RECITALS

A. Lafayette and Lafayette Town Center Associates, a California Limited Partnership entered into that certain Development Agreement dated June 1, 1998 effective as of May 27, 1998, recorded as Document Number 98-0153218-00 (Development Agreement).

B. The Development Agreement provides for the development of certain property in Lafayette as a mixed-use development comprised of three phased components, retail, apartment, and office. (Project)

C. Section 7.06 permits the Developer to assign an interest in the Project subject to the Development Agreement upon receiving City consent unless the transfer is expressly exempt.

D. Lafayette Town Center Associates, after providing notice to Lafayette, transferred its interest in the apartment and office components to Bay Glen as an exempt transfer pursuant to Section 7.06(d) of the Development Agreement.

E. Bay Glen, after providing notice to Lafayette, transferred its interest in the office component to LRP as an exempt transfer pursuant to Section 7.06(d) of the Development Agreement.

F. Lafayette, Christopoulos Properties, and C & H Development Co., as Successors in Interest to Lafayette Town Center Associates, entered into an Assumption Agreement dated September 17, 1998, whereby Lafayette consented to the transfer of the retail parcel and Christopoulos Properties and C & H Development Co assumed all of the duties and obligations of Lafayette Town Center Associates as those obligations relate to the retail parcel.

G. Christopoulos Properties and C & H Development Co., after providing notice to Lafayette, transferred their interest in the retail component to Christopoulos as an exempt transfer pursuant to Section 7.06(d) of the Development Agreement.

H. The Development Agreement was originally to have expired within seven years after its effective date. On or about September 13, 2004, the parties to the Development Agreement executed a First Amendment thereto pursuant to which the term thereof was extended by one year and consent to the transfer of the retail parcel to Christopoulos was confirmed ("First Amendment"). By the date of the First Amendment, the retail component had been fully developed as well as the residential component consisting of an apartment complex owned by Bay Glen, affiliated with LRP. Only the office component remains undeveloped and it is still owned by LRP. LRP retained vehicular and pedestrian access to the real property on which the office component was and is to be constructed and concerning which the potential residential project as hereinafter described may be located. (Phase III Site)

I. In or about January 2005, Lafayette and LRP engaged in discussions regarding the development of Phase III of the Project as a residential luxury condominium development rather than an office project. By that time, Lafayette had created a set of guidelines pursuant to which a luxury condominium project might be constructed on the Phase III Site in lieu of an office project. By that same time, LRP had negotiated a Purchase and Sale Agreement, as Seller, with KB Home South Bay, Inc., (KB) an affiliate of KB Home, as Buyer. In or about July 2005, LRP filed a request for consent to transfer its interest in the Development Agreement and the Phase III Site to KB. Lafayette denied the consent to transfer at a Council meeting held October 11, 2005.

J. On or about January 25, 2006, Lafayette and LRP participated in a mediation of certain disputes between them arising from and related to the Development Agreement. The crux of the disputes was the City Council decision made October 11, 2005 to deny the consent to transfer the Development Agreement and Phase III Site from LRP to KB. At that mediation, it was the contention of LRP that Lafayette's denial of the consent to transfer had caused it damages of at least $1 million. It was the contention of Lafayette that it acted in accordance with the Development Agreement to deny the consent to transfer. At the mediation, the parties reached a conceptual settlement agreement based on their mutual and reciprocal desire to settle and resolve all of the differences and disputes then existing between them.

K. On May 22, 2006 the parties entered into a Settlement Agreement to settle and resolve disputes related to the Development Agreement.

L. On April 9, 2007 the parties entered into a First Amendment to the Settlement Agreement to provide for LRP's release of claims and specify the City's remaining obligations.

M. From Fall 2006 through May, 2007, LRP processed and obtained final approval for the Phase III Site office building originally contemplated under the Development Agreement. Final approval thereof was granted by Lafayette and LRP has finalized its working drawings upon which building permits for the office project might be constructed.

N. In or about February 2007, Lafayette's City Council conducted a noticed public hearing during which a consultant retained by the City, Council Members and LRP revisited the potential for a residential condominium project alternative to the office project then pending. The City's consultant determined that the luxury condominium project contemplated in the Settlement Agreement lacked economic viability. Concurrently, the Council indicated that it would consider a further amendment of the Development Agreement to extend its expiration date by a further year so that Lafayette and LRP might consider a mutually acceptable residential project alternative to the approved office component for the Phase III Site. In May 2007, Lafayette extended the expiration date of the Development Agreement to and including May 27, 2008; concurrently, LRP has proposed to finalize its office project for the Phase III Site, but to defer the issuance of building permits and the commencement of construction for such project pending this Restated Settlement Agreement and the resulting process for consideration of an economically viable residential alternative.

O. By this Amended and Restated Settlement Agreement, subject to ratification by Lafayette's City Council and to the Amendment of the Development Agreement as well as such other and related agreements, ordinances, and general and/or

specific plan(s) as may be required to effectuate the goals of the parties as herein set forth, the parties jointly propose to proceed through the development process described below to determine whether or not development of a residential project can be an acceptable alternative to the current approved Phase III Site office project.

NOW, THEREFORE, for valuable consideration, the receipt and sufficiency of which are hereby acknowledged, including, without limitation, the avoidance of the costs and risks of litigation and/or arbitration, and the mutual covenants and conditions set forth in this Restated Settlement Agreement the parties hereto hereby agree as follows:

1. **Truth of Recitals**:

The parties agree that the foregoing Recitals are true and correct and are incorporated herein by this reference.

2. **Term.**

The term of this Restated Settlement Agreement shall commence upon the Effective Date and shall remain in effect until May 27, 2010 unless terminated, modified, or extended by circumstances set forth by this Restated Settlement Agreement or by mutual consent of the Parties.

3. **Submittal of Amendment(s) of the Development Agreement**:

If and to the extent required, to give effect to this Restated Settlement Agreement, Lafayette agrees that it will accept, in good faith, for processing, review, and prompt action as reasonably possible, amendments to the Phase III Site Development Agreement to accomplish the purposes herein set forth. The parties acknowledge that the process for Amendment of the Development Agreement requires a noticed public hearing before the Planning Commission and City Council pursuant to Government Code section 68564 et seq. The effectiveness of this Restated Settlement Agreement shall be conditioned expressly upon the Amendment of the Development Agreement to provide to LRP the rights and benefits for which it has negotiated all as hereafter set forth, should such Amendment be required.

The parties acknowledge that the potential Amendment of the Development Agreement as well as this Restated Settlement Agreement pertain solely to Phase III of the Project. Accordingly, the Amendment of the Development Agreement shall have no bearing on the Phase I and or II Components nor shall the current owners of the parcels comprising said phases of the Project be parties to any such Amendment. Nothing herein contained, therefore, shall be deemed to alter or affect the rights, title, and/or interest of any owners or tenants of Phase I and Phase II of the Project.

4. **Amendment of Development Agreement.** LRP requests amendment(s) of the Development Agreement in the following particulars:

A. Use. An amendment to the Development Agreement that the permitted use of the Phase III Site office component may be either: (i) an office use as originally contemplated in the Development Agreement or (ii) a residential use in the form of a residential project as further

defined in this Section 4. The election regarding permitted use shall be made by the Developer of the Phase III Site; should the designated permitted use remain as office, then the terms and provisions of the Development Agreement as they existed prior to this Restated Settlement Agreement shall remain in full force and effect save and except with respect to the provisions of this Restated Settlement Agreement regarding extension of the term thereof. In the event the Developer designates the Phase III Site as a Residential Project permitted use, then all of the terms and provisions of this Restated Settlement Agreement shall apply as to that permitted use as that Phase III Site is developed by and under the terms of the Development Agreement as herein amended. The Residential Project shall be subject to Lafayette's standard approval process save and except as modified by the Development Agreement and this Restated Settlement Agreement.

B. Term. An amendment to the Development Agreement that extends the term for no more than two additional years following execution of the Settlement Agreement. The current term of the Development Agreement will expire May 27, 2008 unless extended in accordance with the terms thereof. The parties contemplate, however, that pursuit of a residential project alternative may require a further extension of the current expiration date. The purpose of such extension would be both to secure LRP's rights to proceed with its office project without having to obtain building permits and commence construction and to pursue the residential project alternative to and through project approvals. Potential preliminary approval may include the following aspects/attributes of a residential project alternative: Site plan including public spaces, uses, parking structure/solution, height, mass, and number of units.

C. Fees and Exactions. An amendment to the Development Agreement to provide that the fees payable to Lafayette as otherwise required there under shall be payable at the rate in existence at the time a project application is actually filed in the event the Developer elects to pursue the residential project alternative. (In the event the Developer elects to pursue its existing approved office project, then fees shall be payable as set forth in the Development Agreement prior to any Amendment as herein contemplated.) An amendment to the Development Agreement to include the following specific fees which may be charged by Lafayette in the event LRP determines to pursue a residential project alternative to the currently approved Phase III Site office project:

(a) Such "art fee" as Lafayette may impose as of the date of this Restated Settlement Agreement on projects of the sort and scale of proposed residential development on the Phase III Site;
(b) A contribution to off-site improvements ear marked for the BART pathway/project intersection in a sum not to exceed $100,000; provided, however, any monies so paid shall in fact be allocated to and expended for such purpose in accordance with plans and specifications reasonably approved by LRP. Additionally, the City shall make good faith application for grant monies with which to complete the subject off-site improvements and any monies obtained in such fashion shall reduce LRP's contribution in an amount equal to five (5) percent of the total grant amount. LRP shall not receive any monies in excess of its contribution, in the event five (5) percent of the total grant amount exceeds LRP's contribution.
(c) A contribution in a sum not to exceed $50,000 for a traffic signal at the intersection of Dewing and Mt. Diablo Blvd. (The amount of contribution, if any, shall be based strictly on the incremental increase of traffic, if any, generated by the proposed residential project alternative over that related to the office project.

The foregoing specific fee provisions shall have no application in the event LRP elects to construct its approved office project. The terms and provisions of Section 3.09 of the Development Agreement shall be applicable and given effect in the event a residential alternative project is undertaken save and except with respect to the specific fees set forth in this subsection.

Any and all fees payable in accordance with this paragraph shall be paid concurrently with the issuance of building permits.

D. Applicable Laws. An amendment to the Development Agreement to provide that, in the event the Developer pursues the residential project alternative, Lafayette's building ordinances in existence as of the Effective Date of this Restated Settlement Agreement shall be applicable. The parties acknowledge that a Specific Plan Amendment to the BART Block Specific Plan shall be required to develop a residential project alternative. LRP shall file an application for amendment of the BART Block Specific Plan and Lafayette shall thereafter process the same as necessary to accommodate the planned residential development so long as the potential preliminary approval of said project is indicated following the joint meeting of the Council and subsidiary commissions all as set forth hereafter. The amendment of the Specific Plan shall be with respect to permissible building height. In no case shall the height of the buildings exceed the height of the existing Town Center buildings. (For purposes of this paragraph, the height limitation imposed by the existing Phase II project shall be determined by project height above sea level rather than existing grade.) Save and except with respect to the BART Block Specific Plan Amendment and the provisions of this Restated Settlement Agreement, the applicable laws in effect at the time of execution of the Development Agreement shall apply to the project alternative residential development.

E. Affordable Housing Requirements. An amendment to the Development Agreement to provide the following affordable housing requirements shall be imposed as to the residential project alternative. LRP may provide affordable housing either on site or off site. California Redevelopment Law imposes a 15% affordable housing requirement of which 6% of units are to be allocated for very low income households and 9% of units allocated to low or moderate income households. (The aforesaid state law also imposes certain requirements regarding affordable units for qualified households at very low income, low or moderate income for not less than 55 years for rental units and 45 years for owner-occupied units.) The Developer may elect to meet affordable housing requirements through the provision of off-site units and, in such case, the requirement shall be 15% of the aggregate number of units constructed as required by California Redevelopment Law with 6% thereof allocated to very low and 9% to moderate income units. The election to provide affordable housing either on site or off site shall be that of the Developer with requirements imposed on said election to be made as herein set forth. (Affordable units shall be provided in configurations of one bedroom or two-bedroom units in the same proportion as market rate units comprising the Project.)

Should LRP propose to provide affordable housing on site, requirements related to the number and type of affordable units shall be calculated in a fashion which includes the affordable housing units presently in place at the Phase II Residential Rental Project.

The Phase II Project currently has in place 15 very low income units. That allocation of affordable units exceeds the requirement for very low income households by 10 units and exceeds the overall affordability requirement by 3 units. If it is assumed that Phase III will

consist of 75 units, then the aggregate affordable unit requirement for Phases II and III (comprising 150 units) would be 23. Since the very low income household unit requirement for Phase II already exceeds the entire very low income requirement for Phases II and III together, there shall be no requirement for additional very low income household units. In order to satisfy affordability requirements based on a combined 150 unit count between Phases II and III, the remaining shortfall in affordable units (8) shall be constructed as a part of Phase III and shall be allocated to moderate income households. (The foregoing calculation is illustrative only as the number of units comprising the Phase III alternative has yet to be determined. Therefore, affordability requirements shall be calculated with respect the aggregate number of units comprising both Phases II and III with credit given for excess Phase II units against requirements otherwise applicable to Phase III.)

In the event LRP elects to provide affordable housing off site, then the 15% affordable housing requirement of California Redevelopment Law shall apply and the Developer shall provide 6% of the units for very low income households and 9% of the units for low or moderate income households.) (By way of example, should the project be composed of 80 units, affordable housing requirements shall be satisfied by means of a credit of four (4) very low units; the provision of four (4) very low units and the provision of four (4) moderate for a total of eight (8) new affordable units.)

The terms "very low income households" "low" and "moderate income" shall have the same meanings as set forth in California Health Safety Code and Section 50052.5 as that section may be amended from time to time and shall provide an allowance for utilities and maintenance costs established by the State of California Department of House and Community Development, plus the actual homeowners association fees, dues and assessments as established from time to time. "Area median income" as referenced in California Health and Safety Code Section 50052.5 shall mean the area median income for Contra Costa County, California. as permissibly adjusted for family size appropriate for the unit by the State of California Department of Housing and Community Development in accordance with adjustment factors adopted and amended from time to time by the US Department of Housing and Urban Development pursuant to Section 8 of the United States Housing Act of 1937 and California Health and Safety Code Section 50093.

F. Attributes of a Residential Project Alternative. An amendment to the Development Agreement to include the following conceptual summary of the attributes of a residential project the parties jointly find to be an acceptable use:

a. The architectural firm Heller-Manus has previously conducted conceptual studies of the Phase III project site for development of a residential project. LRP shall retain Heller-Manus to produce plans acceptable to it intended to create an economically viable development project; provided, however, the general foot print, general elevations, general site plan and general plaza dimensions of the original Heller-Manus work product shall be retained. (The parties acknowledge that the foregoing does not directly address building height; the height limitations applicable to the project shall be as defined in Section 4D above.)

b. There shall be no restaurant use requirement imposed by Lafayette as to the project, provided that an acceptable open space substitute (e.g., enlarged plaza, children's fountain/playground/spray ground, sculpture park) or, alternatively, a public or quasi-public interior space substitute (e.g., art gallery, chamber of commerce office, non-profit foundation) is proposed that meets City parking

requirements. In addition, there shall be no requirement for live/work units, provided that an acceptable alternative is proposed that enlivens the southern edge of the development that meets City aesthetic requirements. LRP shall apply for a Land Use Permit to define the specific acceptable open space substitute or public or quasi public interior space substitute for the prior required restaurant use. The issuance of a Land Use Permit shall be a condition precedent to use of the referenced space—but not to approval of the Project itself.

c. Exterior finishes and materials used on the buildings, the plaza, and the pedestrian pathway and the proposed landscaping shall be of the highest quality, shall respect and reflect the creek side setting of the project, and be commensurate with the single family and environmentally-sensitive quality of residential buildings in Lafayette. The City will require the extensive use of architectural features involving a variety of building materials including stone, brick, minimal use of smooth trowelled stucco, and wood for the exterior of the buildings. Other materials and finishes that are consistent with a high quality residential project may be offered by LRP as alternatives. Approval of such materials is at the discretion of the City.

d. All matters involving non-public spaces and portions of the project and/or individual units which are not viewable from off-site shall be matters determined by LRP at its sole and exclusive discretion. (The foregoing specifically includes all interior finishes, fixtures and amenities of every kind and sort.)

e. Parking requirements shall not exceed two spaces per unit and shall be otherwise limited to one space per bedroom. Parking requirements may be satisfied by tandem spaces and/or "lifts"; provided, however, such alternatives must be reviewed and approved by a qualified traffic engineer and the City's engineer to ensure feasibility.. LRP shall provide parking as set forth above and shall also include replacement parking for any spaces lost in the retail parking lot in addition to required spaces pursuant to prior agreements (e.g. CC&Rs, Development Agreement etc).

5. **Loan Extension.**

The parties acknowledge that LRP is currently obligated to Lafayette in the principal sum of $458,524 plus interest pursuant to the terms of a certain Promissory Note executed May 31, 2005. The aforesaid indebtedness is presently due and payable on or before May 27, 2008 (save and except as the term thereof may be affected by the Development Agreement, and/or this Restated Settlement Agreement. An amendment of the term of the Development Agreement as set forth in Section 4B above shall automatically extend the maturity date of the referenced loan. Notwithstanding the foregoing, the above referenced Promissory Note shall be immediately due and payable on the earlier of: (1) termination of the Development Agreement or (2) the date of close of escrow for the sale of the Phase III Site to a third party.

6. **Approval Process:**

From and after the execution and/or ratification of this Restated Settlement Agreement, LRP shall retain Heller-Manus Architects to produce the conceptual/schematic plans required for approval of a residential project. The aforesaid plans shall be based upon prior work product from that same firm previously reviewed by Lafayette in the context of the original Settlement

Agreement. The Heller-Manus revised work product prepared for the LRP residential project alternative shall:

Retain the general footprint, general elevations, general site plan and general plaza dimensions of the earlier proposal;

Create a housing development that is economically viable from the standpoint of LRP; and

Provide a feasible design for a naturally ventilated parking garage that meets City aesthetic requirements and that responds to the requirement to enliven the southern edge of the development all with access to or from Dewing/Mt. Diablo Blvd. Nothing herein contained shall be deemed to prohibit LRP from substituting an underground parking garage structure in the place and instead of a proposed naturally ventilated parking garage as described herein above.

As soon as such Heller-Manus plans are available and have been delivered to Lafayette, a joint meeting of the City Council, Planning Commission, and Design Review Commission shall be scheduled. The said joint meeting shall occur within 30 days of delivery of all plans and submittals required by the City. The plans shall be schematic and may include cut sheets to provide information regarding architectural details. The plans shall include elevations, site plan, a conceptual landscape plan, parking and circulation, proposed lighting, paving, furniture, art, colors and a materials board related to the building. At its joint workshop meeting, Lafayette shall make preliminary comments regarding the potential preliminary approval or disapproval of the Project utilizing such procedures for recording comments of each body. (Project Preliminary Comments).

If the Project Preliminary Comments indicate potential approval of the project, then Lafayette staff will produce submittal requirements for consideration by the Design Review Commission (DRC), Planning Commission and City Council. Submittal requirement shall include all CEQA compliance requirements; provided, however, the prior EIR Studies and Addenda shall be considered (including those related to an earlier proposed apartment project for the Phase III Site). Otherwise, submittal requirements shall be limited to matters legally required for project consideration and directly responsive to comments from Council Members and Commissioners.

Within 30 days of the date on which the LRP Application shall be deemed to have been complete and the appropriate CEQA analysis shall have been completed, the DRC shall consider the plans from the joint meeting and Project submittal requirement at a hearing. The scope of DRC review shall be to recommend approval, conditional approval, or rejection of the plans and submittals furnished by LRP. The DRC action shall be completed within 45 days of the first DRC meeting on the Project unless LRP fails to provide any information or anything else necessary to act on the Application, including anything necessary for CEQA compliance.

The DRC's recommendation shall be forwarded to the Planning Commission as soon as possible, but no later than 30 days following DRC action. The Planning Commission shall take action on the LRP Application within 45 days of the first Planning Commission meeting on the Project, unless LRP fails to provide any information or anything else necessary to act on the application, including anything necessary for CEQA compliance.

The Planning Commission's recommendation shall be forwarded to the City Council as soon as possible. The City Council's action must be completed within 45 days of the first City Council meeting on the Project unless LRP fails to provide any information or anything else necessary to act on the application, including anything necessary for CEQA compliance. Such review shall include a CEQA determination and action on the Tentative Subdivision Map.

The parties acknowledge that the City may consider fees or exactions in addition to those listed in Section 4(C), revised plans, or other measures not specified in this Agreement that are designed to mitigate an environmental impact, as determined by the CEQA process, and those measures shall not be considered to violate this Agreement. The parties acknowledge that CEQA may require that an addendum or other environmental review be prepared to address potential environmental impacts created by a Residential Project Alternative. It is acknowledged that LRP previously submitted an application for a Phase III Residential Project and that CEQA studies related thereto, as amended or supplemented, shall be reviewed and an addendum updating traffic and visual impacts may be used in the CEQA analysis of the Phase III Residential Project Alternative.

If final Project approval of the Phase III Residential Project Alternative is granted, and if LRP elects to pursue that Project, then the fees and exactions set forth in 4C above shall be paid as therein set forth.

7. **Elections Available to LRP**:

Notwithstanding anything to the contrary herein contained, LRP may elect to build its approved office development at the Phase III Site, in which case the terms and provisions of the Development Agreement save and except as to the term thereof shall remain unchanged and in full force and effect. In such instance, the Restated Settlement Agreement shall have no application to the office project (although the Development Agreement shall remain in force and effect.) Additionally, LRP retains the right to designate any Assignee as the proposed Assignee of the Development Agreement, as modified by this Restated Settlement Agreement, and the proposed purchaser of the Phase III Site real property. Should LRP propose to transfer its interest in the Development Agreement and the Phase III Site, then the provisions of Section 7.06 of the Development Agreement shall be applicable to any such proposed transfer and shall remain in full force and effect. The amendment of the Development Agreement by this Restated Settlement Agreement shall be given effect so long as a residential project is proposed notwithstanding the assignment by LRP should such assignment be made.

8. **Acknowledgment of Effect of Prior Settlement Agreement**:

The parties acknowledge that the original Settlement Agreement dated May 22, 2006 as amended on April 9, 2007, has been given effect including, particularly, the general releases therein set forth. To the extent the Settlement Agreement has been amended and restated in this document, however, the terms and provisions hereof shall take precedence over and supersede like or other provisions found therein.

A. Release by LRP of Lafayette.

Except for the obligations set forth in this Restated Settlement Agreement, including those obligations imposed by and under the terms of the Development Agreement as it may be amended in a fashion consistent herewith, LRP, on behalf of itself and its agents, employees, representatives, officers, directors, managers, members, attorneys, insurers, corporate parents, subsidiaries, affiliates, owners, shareholders, partners, assigns, and predecessors and successors-in-interest (collectively, the "LRP Parties"), hereby irrevocably and forever releases, discharges, waives, relinquishes, settles, and forgives, all rights, interests, claims, liabilities, demands, damages, costs, attorneys' fees, disputes, obligations, charges, complaints, and causes of action of whatever kind or nature, whether known or unknown, whether absolute or contingent and whether based on contract, tort, statutory or other legal or equitable theory of recovery, which LRP and the LRP Parties may have or had against Lafayette, and Lafayette's respective agents, employees, representatives, officers, directors, managers, members, attorneys, insurers, corporate parents, subsidiaries, affiliates, owners, shareholders, partners, heirs, and spouses, assigns, and predecessors and successors-in-interest (collectively, "Lafayette Parties") arising from or related to the exposed assignment of rights under the Development Agreement and proposed sale of real property all as set forth in Paragraphs I, J, and O of the Recitals above ("Claims"). Notwithstanding the foregoing, nothing in this Paragraph shall be deemed to constitute a waiver or release of any of LRP's rights under this Restated Settlement Agreement or the Development Agreement other than such rights of actions as relate to the refusal of Lafayette to consent to transfer to KB all as set forth in its Resolution adopted October 11, 2005.

B. Release by Lafayette of LRP.

Except for the obligations set forth in this Restated Settlement Agreement, including those continuing obligations as may be imposed under the Development Agreement as it may be amended in a fashion consistent herewith, Lafayette, on behalf of itself and the Lafayette Parties, hereby irrevocable and forever releases, discharges, waives, relinquishes, settles and forgives, all rights, interests, claims, liabilities, demands, damages, costs, attorneys' fees, disputes, obligations, charges, complaints and causes of action of whatever kind of nature, whether known or unknown, whether absolute or contingent and whether based on contract, tort, statutory or other legal or equitable theory of recovery, which Lafayette and the Lafayette Parties may have or have had against LRP and the LRP Parties arising from and/or related to the disputes and maters set forth in Paragraphs I, J, O of the Recitals to this Restated Settlement Agreement. Notwithstanding the foregoing, nothing in this Paragraph should be deemed to be a waiver or release of Lafayette's rights under this Restated Settlement Agreement or the Development Agreement as it may be amended in a fashion consistent herewith.

C. Effect and Nature of Release.

The releases stated in Section 8A and B, above extend to all claims, liabilities, and obligations whether or not claimed or suspected by the parties to this Restated Settlement Agreement, and the releases constitute a waiver of each and all of the provisions of Section 1542 of the California Civil Code, which reads as follows:

> **"A general release does not extend to claims which the creditor does not now or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor."**

The parties acknowledge that the effect and import of the provisions of Section 1542 have been explained to them by their own independent counsel or that such independent counsel

was available to each of them prior to the execution of this Restated Settlement Agreement. The parties further acknowledge that this waiver of rights under Section 1542 of the Civil Code has been separately bargained for and is an essential and material term of this Restated Settlement Agreement and that, without this waiver, the parties would not have entered into this Restated Settlement Agreement.

9. **Covenant by Parties Not to Sue**. Each party covenants and agrees that he, she or it shall not, directly or indirectly, bring, commence, initiate, institute, maintain or prosecute any action, suit or other proceeding of any kind or nature against a party to whom he or it has given a release, which is based, in whole or in part, on any claim or cause of action covered by the releases contained in this Restated Settlement Agreement that this Restated Settlement Agreement may be pleaded as a full and complete defense and bar to, and may be used as the basis for an injunction against, any action, suit or other proceedings which may be commenced initiated, instituted, prosecuted, maintained or otherwise threatened or attempted in breach or violation of the provisions of this Section. The provisions of this Section shall not apply to the breach or threatened breach of any of the covenants, agreements, duties, obligations, representations or warranties contained in this Restated Settlement Agreement.

10. **Warranties and Representations**. The parties and each of them warrant and represent that: They have authority to enter into this Restated Settlement Agreement and to amend the Development Agreement in a fashion consistent with this Restated Settlement Agreement and that neither has assigned to any third party any rights hereunder save and except as set forth in the Recitals hereto.

The parties expressly acknowledge that this Restated Settlement Agreement may only be given effect by action taken by the City Council to ratify and affirm the Restated Settlement Agreement in the fashion consistent herewith. Lafayette shall exercise its best efforts and due diligence to present this Restated Settlement Agreement and any proposed amendment to the Development Agreement which might be required to its City Council and to obtain the affirmative concurrence of its City Council to all of the terms and provisions herein set forth. This Restated Settlement Agreement shall be ratified by the City Council as soon as possible.

11. **Indemnification**. LRP shall defend, indemnify and hold Lafayette, its officials, employees, volunteers and agents free and harmless from any and all claims, demands, causes of action, judgments, awards, decrees, costs, expenses, liability, loss, damages or injuries, in low or equity, in any manner arising out of or in connection with the proposed amendment(s) to the Development Agreement and vehicular and pedestrian access to the property as described in greater detail in Recital H of this Restated Settlement Agreement, including, without limitation the payment of all consequential damages and attorneys' fees and other related costs and expenses. LRP shall defend (using one attorney, to be reasonably approved by the City), at LRP's own costs, expenses and risk, any and all aforesaid suits, actions or other legal proceedings of every kind that may brought or instituted against Lafayette, its officials, officer, employees, agents or volunteers. LRP shall pay and satisfy any judgment, award or decree that may be rendered against Lafayette or its officials, officers employees, agent or volunteers, in any such suit, action or other legal proceeding. LRP shall reimburse Lafayette and its directors, officials, officers, employees, agents and/or volunteers, for any and all legal expenses and costs incurred by each of them in connection therewith or in enforcing the indemnity herein provided. This indemnification shall survive the expiration of this Restated Settlement Agreement.

12. **Covenant of Further Assurances**. Each party agrees to execute such other documents and perform such other acts as may be necessary or desirable in order to carry out the purposes of this Restated Settlement Agreement.

13. **Representation By Counsel**. Each party acknowledges that he, she or it has had the opportunity to seek advice of independent legal counsel in connection with this Restated Settlement Agreement and that he, she or it each understands the meaning of every term of this Restated Settlement Agreement and the consequences of signing this Restated Settlement Agreement.

14. **Agreement Entered Into With Independent Judgment**. Each party acknowledges that he, she or it has had the opportunity to seek advice of independent legal counsel in connection with this Restated Settlement Agreement and that he, she or it understands the meaning of every term of this Restated Settlement Agreement and the consequences of signing this Restated Settlement Agreement. Each party further declares and represents that he, she or it have reviewed this Restated Settlement Agreement in its entirety and that, in entering into this Restated Settlement Agreement, he, she or it relied wholly on his, her or its own respective judgment, belief, knowledge, investigation, independent legal advice and research and that he, she or it has not been influenced to any extent whatsoever in making this Restated Settlement Agreement by any representations or statements regarding the same by any other party or by any person or persons representing or acting for any other party.

15. **No Admission of Liability:** Neither the negotiation nor the execution nor the performance of this Restated Settlement Agreement by any party shall constitute an admission or concession of liability or wrongdoing by any party nor any other form of admission with respect to any matter or dispute whatsoever and any such liability or wrongdoing is expressly denied.

16. **Attorneys' Fees and Costs**. The parties agree to each bear their own attorneys' fees and costs in connection with the Action and this Restated Settlement Agreement. The parties further agree that the prevailing party in any action or proceeding to enforce or interpret this Restated Settlement Agreement shall be entitled to recover from the other parties its actual attorneys' fees and costs in connection with that action or proceeding.

17. **Entire Agreement**. This Restated Settlement Agreement constitutes the entire agreement between the parties concerning the matters set forth in this Recitals except as otherwise set forth herein, supersedes all prior or contemporaneous agreements, understandings, and proposals. This Restated Settlement Agreement may be modified only by a written instrument executed by both parties.

18. **Counterparts**. This Restated Settlement Agreement may be executed in counterparts, each of which will be deemed an original, but all of which taken together will constitute one and the same instrument.

19. **Governing Law**. This Restated Settlement Agreement will be governed by and construed in accordance with the laws of the State of California.

IN WITNESS WHEREOF, the parties each have executed this Restated Settlement Agreement as of the day and year first above set forth.

LAFAYETTE RESIDENTIAL PARTNERS, LLC, a Delaware Limited Liability Company

By: _____

By: _____

CITY OF LAFAYETTE, A CALIFORNIA MUNICIPAL CORPORATION

By: _____

Mike Anderson, Mayor

October 6, 2008

Niroop Srivatsa and Steven Falk
c/o Joanne Robbins
City of Lafayette
3675 Mt. Diablo Blvd.
Lafayette, CA 94549

RE: KB Home Qualifications Summary

KB HOME RELATED EXPERIENCE

Founded in 1957, this year marks KB Home's 51st anniversary in business. Few companies achieve this milestone. KB Home's mission is to redefine the industry by creating a premier, disciplined, process driven company as measure by our customers, employees, shareholders, and business partners. The discipline and focus can be found in the KBnxt Business Model that was developed and implemented over 10 years ago. This business model provides the means by which KB Home offers customers greater choice and control over the construction of their home while shielding the company from the risks of speculative building.

KB Home South Bay Inc. is one of the 30 divisions operating under the umbrella of KB Home. The Division has been operating in Northern California since 1968 for almost 40 years. The South Bay Division facilitates projects throughout Santa Clara County, Alameda County, and Contra Costa County. South Bay is consistently one of the top operating Divisions in the Company and one of the leading home builders in the Bay Area. In addition to consistently impressive financial results the success of the South Bay Division is better evidenced by a 95% customer satisfaction rating over a steadily increasing home delivery base. Over the past 10 years the home deliveries for the South Bay have more than doubled to over 1,000 homes per year.

Operational Stability

KB Home South Bay focuses strategically on developments and development opportunities where the demand is high and where families can enjoy a good quality of life. KB Home has been recognized for our leadership in providing master planned communities, single-family dwellings, town homes and condominiums, and mixed-use, high density infill developments. We focus on operational excellence through the diligent tracking of homebuyers' experiences, preferences, and satisfaction indexes.

Financial Strength

KB Home operates with one of the largest credit lines in the homebuilding industry. We are also using the debt and equity of other partners and domestic banks, to finance projects. Our financial capability is important not only in the ability to purchase property but to take the time needed to plan and deliver on entitlement commitments.

Management Excellence

Equally important as the financial strength of the company is the expertise of the local management team which oversees the planning, construction, quality, efficiency and profitability of each project. The management team is experienced working closely with cities, counties, local agencies, neighbors and community groups, to build projects that are mutually beneficial.

Another aspect of management success is the working relationship between the South Bay Division and the KB Home Corporate office. New project opportunities are identified, once approved by a corporate panel, the local team is fully empowered to bring that project to fruition.

Smart Building

The KBnxt Business model provides several proactive business strategies to help protect the Division from the vulnerability of the real estate market. There is a process of extensive and continual surveying and analyzing a region and its demographics to ensure that market knowledge is driving land acquisition and development activities. We provide our customers with extensive opportunities for choice. KB Home does not "spec" build houses, nor force unwanted options on our customers. Buyers opt for the level of options they choose for their lifestyle.

Community Involvement

While KB Home is a Fortune 500 company, we know that real estate is really a local business. The staff of the South Bay Division work to understand the needs of the local community, and wherever possible, work within those parameters. Meeting with neighborhood groups and businesses in community forums or one-on-one is some of the most valuable time spent to ensure the success of a project. Giving back to the

communities in which we build is an important aspect of the South Bay's commitment to the community. Donations to schools and local charities, the building and dedication of parts and open spaces, sponsorship of youth activities, and clothing and food drives, are just a few of the ways KB Home gives back to the community.

The following is a list of related condominium projects located throughout the East Bay.

Carrara @ Tuscany Hills, 86 units, San Jose
Sonora @ Montebello, 105 units, Fremont
Cannery Square @ Monte Vista, 235 units, San Jose
Luna @ Terra Serena, 315 units, Milpitas
Midtown Plaza, 257 units, San Jose

We have also enclosed the biographies of our local senior management as well as the financial statements of KB Home. We look forward to working with you in the future.

Sincerely,

Jeffrey P. McMullen
Sr. Vice President Land Acquisition
KB Home South Bay, Inc.

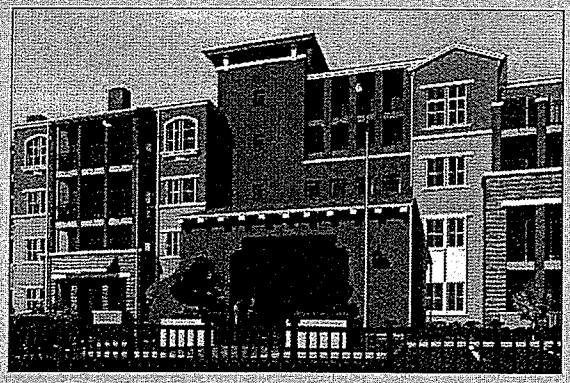
cc: Rick Dishnica
Ivan Glover

Sonora @ Montebello

Fremont, CA

Sonora @ Montebello

KB Home's condominium community, Sonora, is located in Fremont, a central location that provides easy access to Silicon Valley and the East Bay. Sonora is located in Southern Fremont between highways 680 and 880, and is within close proximity to major universities, shopping and dining.



Plan Information:

905 to 1,853 square feet
6 floor plans
1 and 2 story homes
1-3 bedrooms
1-3 bathrooms

Site Size:
2.1 acres

Unit Mix/Plans:
105 condominium style homes

Unit Square Footage:
905 – 1,853 square feet

Amenities:
Private clubhouse and a landscaped private courtyard for residents

KB HOME BUILT TO ORDER

Cannery Square @ Monte Vista

San Jose, CA

Cannery Square @ Monte Vista

KB Home's condominium community, Cannery Square, is located in the historical Del Monte Cannery property. Just minutes from downtown San Jose, Cannery Square is within close proximity to Interstates 680, 880, 280, and Highway 101.

Plan Information:

824 to 1,433 square feet
5 floor plans
1 story homes
1-3 bedrooms
1-2 bathrooms

Site Size:
3 acres

Unit Mix/Plans:
235 condominium style homes

Unit Square Footage:
824 – 1,433 square feet

Amenities:
Proposed park with bocce ball court, picnic benches, and BBQ area

KB HOME BUILT TO ORDER

Luna @ Terra Serena

Milpitas, CA

Luna @ Terra Serena

KB Home's condominium community, Luna @ Terra Serena, is located on South Abel Street near the Great Mall in Milpitas, "The Gateway to the Silicon Valley". Positioned on a major arterial path, Luna enjoys quick access to the Great Mall, VTA and Interstates 680, 880 and 237.

Plan Information:

905 to 1,853 square feet
6 floor plans
1 story homes
1-3 bedrooms
1-2 bathrooms

Site Size:
8.46 acres

Unit Mix/Plans:
(3) 105 unit condominium buildings

Unit Square Footage:
905 – 1,853 square feet

Amenities:
Clubhouse, pool, fitness center, tot lot, BBQ area, and car-wash area

KB HOME BUILT TO ORDER

Midtown Plaza

San Jose, CA

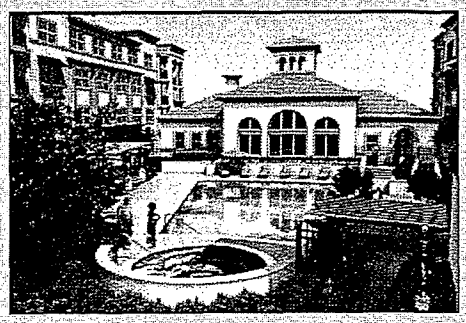
Midtown Plaza

KB Home's condominium community, Midtown Plaza was built on the famous Saddlerack property in San Jose. The community is within minutes of shopping, dining, entertainment and San Jose State University.

Plan Information:

744 to 1,340 square feet
5 floor plans
1 story homes
1-3 bedrooms
1-2 bathrooms

Site Size:
6 acres
Unit Mix/Plans:
257 condominium style homes
Unit Square Footage:
744 – 1,340 square feet
Amenities:
2.5-acre park
Pool



KB HOME BUILT TO ORDER

Carrara @ Tuscany Hills

San Jose, CA

Plan Information:

937 to 1,640 square feet
4 floor plans
1 story homes
1-3 bedrooms
1-2 bathrooms

Carrara @ Tuscany Hills

KB Home's condominium community, Carrara at Tuscany Hills is located in the heart of Silicon Valley near shopping, dining and entertainment. The community is within close proximity to highways 101, 87 and 85.

Site Size:
1.3 acres

Unit Mix/Plans:
86 condominium style homes

Unit Square Footage:
937 to 1,640 square feet

Amenities:
Pool
Recreation Building
Storage
1.3 Acre Park

KB HOME BUILT TO ORDER

Chris Apostolopoulos
President

KB Home South Bay, Inc.
6700 Koll Center Parkway, #200
Pleasanton, CA 94566
925-750-1700

Chris G. Apostolopoulos is President of KB Home South Bay, one of the Bay Area's largest and most successful homebuilder with over 20 active communities providing 1,000 new homes annually.

As President, Mr. Apostolopoulos is responsible for the operations of the Bay Area business including but not limited to all operational activities, land acquisition, land development, sales, construction, customer service, finance and profit and loss for all of the homebuilder's new home communities in 12 counties throughout the Bay Area.

A second generation builder Mr. Apostolopoulos started his career in the family homebuilding business and brings more than 20 years of experience in developing multi-family, production and custom-home communities throughout the Bay Area.

Previously, Mr. Apostolopoulos served as the division president to KB Home Central Valley. With his leadership he developed, and managed the operations and successfully expanded the Central Valley portfolio. Additionally, Mr. Apostolopoulos led the division to receive top honors from JD Powers and Associates as well as the distinction of Best New Home Builder in San Joaquin county three years in a row.

Prior to this he served as Senior Vice President and Business Manager for KB Home North Bay focusing on operations and profit and loss management. As Vice President of Land Acquisition and Planning for KB Home's North Bay division, Mr. Apostolopoulos was responsible for site identification, contract negotiations, due diligence, market and financial analysis for all new acquisitions in 16 counties. In this capacity Mr. Apostolopoulos acquired in excess of 20,000 units representing an investment of over $3 billion.

Mr. Apostolopoulos is a policy advisory board member of the Fisher Center for Real Estate & Urban Economics at the University of California Haas School of Business, a board member of the Chairman's Council of Home Builders Association of Northern California, a board member of the Bay Area Council, a board member of the Bay Area Leadership Foundation, and is actively involved in many philanthropic organizations involving his Greek heritage. Mr. Apostolopoulos holds a Bachelor of Science degree from the University of California, Davis with graduate studies at San Francisco School of Law.

In addition to his career responsibilities, Mr. Apostolopoulos is also a dedicated husband to Eleni his wife of nine years. They have two beautiful children, George 8 and Demi 5 years of age.

Jeffrey P. McMullen
Senior Vice President Land Acquisition

KB Home South Bay Inc.
6700 Koll Center Parkway, #200
Pleasanton, CA 94566
925-750-1714

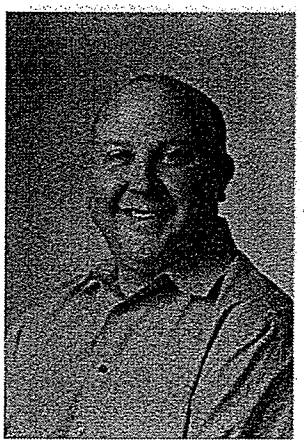
jmcmullen@kbhome.com

Jeffrey McMullen coordinates all land search and new development opportunities for KB Home's South Bay Division. He is responsible for analyzing and preparing offers on all new property, negotiating and preparing land purchase agreements with land owners, coordinating due diligence efforts, managing existing purchase contracts, maintaining buyer and seller relationships and structuring equity and lender financing arrangements. He has successfully acquired highly complex deals and worked in most communities in the San Francisco Bay Area. McMullen has been with KB Home for more than nine years and has more than 20 years of experience developing residential subdivisions and multi-family projects in the San Francisco Bay Area. Prior to joining KB Home, McMullen spent 11 years planning and developing residential property for The Mission Peak Company. He holds a bachelor's degree in civil engineering from the University of the Pacific and a MBA from Southern Methodist University. He is a registered civil engineer, a licensed general contractor and real estate broker for the State of California.

Ray Panek
Senior Vice President, Forward Planning

KB Home South Bay Inc.
6700 Koll Center Parkway, #200
Pleasanton, CA 94566
925-750-1713
510-719-4302 (cell)

rpanek@kbhome.com



In his current position Ray Panek manages the design, entitlement, permitting and development of all KB Home projects in the greater San Francisco Bay Area. During his 10 years with KB Home he as been involved in the entitlement and development of over 5,000 residential units in this geographic area. KB Home has entitled and developed major projects from Monterey County to the south to Fairfield and Petaluma to the north. The major markets for the South Bay Division include San Jose and the southbay, Alameda County and Contra Costa County.

He also serves as Vice Chairman of the Home Builders Association of Northern California (HBANC) and is immediate past President of the Southern Division of HBANC. Prior to joining KB Home Panek was the principal planner for the City of Concord, CA; manager for the Concord Redevelopment Agency and a planner for the City of Elizabeth, New Jersey. Redevelopment projects in the City of Concord for which he was responsible include construction of a new police station, auto center, multi-plex cinema, Home Depot center and various residential projects.

Panek holds a BS degree in Landscape Architecture with honors from Rutgers University and a MBA from the University of San Francisco.

2007 ANNUAL REPORT
KB HOME

PART I

Item 1. BUSINESS

General

KB Home is a Fortune 500 company listed on the New York Stock Exchange under the ticker symbol "KBH." We are one of the nation's largest homebuilders and commemorated our 50th year in the homebuilding industry in 2007. We construct and sell homes through our operating divisions across the United States under the name KB Home. Unless the context indicates otherwise, the terms "the Company," "we," "our" and "us" used herein refer to KB Home, a Delaware corporation, and its predecessors and subsidiaries.

Beginning in 1957 and continuing until 1986, our business was operated through various subsidiaries of Kaufman and Broad, Inc. ("KBI") and its predecessors. In 1986, KBI transferred to us the outstanding capital stock of its subsidiaries conducting KBI's homebuilding and mortgage banking business. Shortly thereafter, we completed an initial public offering of 8% of our common stock and began operating under the name Kaufman and Broad Home Corporation. In 1989, we were spun-off from KBI, which then changed its name to Broad Inc., and operated as an independent company, primarily in California and France. In 2001, we changed our name to KB Home. Since 1989, we have expanded our business in both our existing markets and into new markets through capital investments and acquisitions of a number of other homebuilders. Today, we operate a geographically diverse homebuilding and financial services business serving homebuyers in markets across the United States. We believe our geographic diversity helps to mitigate the effects of local and regional economic cycles, enhancing our long-term growth potential.

Our four homebuilding segments offer a variety of homes designed primarily for first-time, first move-up and active adult buyers, including attached and detached single-family homes, townhomes and condominiums. We offer homes in development communities, at urban in-fill locations and as part of mixed-use projects. We use the term "home" to refer to a single-family residence, whether it is a single-family home or other type of residential property, and we use the term "community" to refer to a single development in which homes are constructed as part of an integrated plan.

We delivered 23,743 homes in 2007 compared to our record 32,124 homes delivered in 2006. In 2007, our average selling price of $261,600 decreased from $287,700 in 2006. We generated total revenues of $6.42 billion and a loss from continuing operations of $1.41 billion in 2007 compared to total revenues of $9.38 billion and income from continuing operations of $392.9 million in 2006. Our homebuilding revenues, which include revenues from land sales, accounted for 99.8% of our total revenues in both 2007 and 2006. Our results in 2007 reflected the significant market downturn the homebuilding industry experienced throughout the year, and our actions to align our operations with the diminished sales environment and to strengthen our balance sheet.

Our financial services segment derives income from mortgage banking, title and insurance services offered to our homebuyers. Mortgage banking services are provided through Countrywide KB Home Loans, a joint venture operated by Countrywide Financial Corporation ("Countrywide") that offers a variety of loan programs to serve the needs of our homebuyers. Our financial services segment accounted for .2% of our total revenues in both 2007 and 2006.

On July 10, 2007, we sold our 49% equity interest in our publicly traded French subsidiary, Kaufman & Broad S. A. ("KBSA"). Accordingly, we now operate our homebuilding and financial services business solely in the United States.

Our principal executive offices are located at 10990 Wilshire Boulevard, Los Angeles, California 90024. The telephone number of our corporate headquarters is (310) 231-4000 and our website address is http://www.kbhome.com. Our Spanish-language website is http://www.kbcasa.com. In addition, location and community information is available at (888) KB-HOMES.

Markets

Our homebuilding operations span the United States from coast to coast. Because of the geographic reach of our homebuilding business, we have four homebuilding segments based on the markets in which we construct homes — West Coast, Southwest, Central and Southeast. We operate in the 13 states and 35 major markets shown below:

Segment	State(s)	Major Market(s)
West Coast	California	Fresno, Los Angeles/Ventura, Oakland, Orange County, Riverside, Sacramento, San Bernardino, San Diego and Stockton
Southwest	Arizona	Phoenix and Tucson
	Nevada	Las Vegas and Reno
	New Mexico	Albuquerque
Central	Colorado	Colorado Springs and Denver
	Illinois	Chicago
	Texas	Austin, Dallas/Fort Worth, Houston and San Antonio
Southeast	Florida	Daytona Beach, Jacksonville, Lakeland, Melbourne, Orlando, Sarasota and Tampa
	Georgia	Atlanta
	Maryland	Washington, D.C.
	North Carolina	Charlotte and Raleigh
	South Carolina	Bluffton/Hilton Head, Charleston and Columbia
	Virginia	Washington, D.C.

Segment Operating Information. The following table sets forth specific operating information for our homebuilding segments for the years ended November 30, 2007, 2006 and 2005:

	Years Ended November 30,		
	2007	2006	2005
West Coast:			
Homes delivered	4,957	7,213	6,624
Percent of total homes delivered	21%	22%	21%
Average selling price	$433,600	$489,500	$460,500
Total revenues (in millions) (a)	$ 2,203.3	$ 3,531.3	$ 3,050.5
Southwest:			
Homes delivered	4,855	7,011	7,357
Percent of total homes delivered	20%	22%	24%
Average selling price	$258,500	$306,900	$265,600
Total revenues (in millions) (a)	$ 1,349.6	$ 2,183.8	$ 1,964.5
Central:			
Homes delivered	6,310	9,613	9,866
Percent of total homes delivered	27%	30%	32%
Average selling price	$167,800	$159,800	$157,600
Total revenues (in millions) (a)	$ 1,077.3	$ 1,553.3	$ 1,559.0
Southeast:			
Homes delivered	7,621	8,287	7,162
Percent of total homes delivered	32%	26%	23%
Average selling price	$229,400	$244,300	$215,100
Total revenues (in millions) (a)	$ 1,770.4	$ 2,091.4	$ 1,549.3
Total:			
Homes delivered	23,743	32,124	31,009
Average selling price	$261,600	$287,700	$261,200
Total revenues (in millions) (a)	$ 6,400.6	$ 9,359.8	$ 8,123.3

(a) Total revenues include revenues from housing and land sales.

Unconsolidated Joint Ventures. The above tables do not include deliveries from unconsolidated joint ventures. From time to time, we participate in the acquisition, development, construction and sale of residential properties through

unconsolidated joint ventures. Our unconsolidated joint ventures delivered 127 homes in 2007, 4 homes in 2006 and 83 homes in 2005.

Strategy

We expect the difficult conditions we experienced in our served markets in 2007 to continue through 2008. Consistent with the general downturn in housing markets across the United States, most of our served markets have faced a persistent oversupply of new and resale homes available for sale, with some areas reaching historically high levels. In these markets, our business has encountered significant challenges from heightened builder and investor efforts to sell homes and land, increased foreclosure activity, consumer reluctance to purchase homes, tighter lending standards due to turmoil in the mortgage finance and credit markets, and reduced home affordability, particularly in areas that experienced rapid sales price increases in the years leading up to and including 2006. These conditions resulted in both lower overall sales in our homebuilding business compared to prior years and downward pressure on our selling prices and margins in 2007, as competition for sales drove marketing expenses higher and increased the need for sales incentives. We do not expect the present business environment in our served markets of these trends to improve in 2008.

We believe our continued adherence to the disciplines of our core built-to-order operational business model, KBnxt, will enable us to manage through the current and expected near-term business environment. We believe it will also position us to capitalize on long-term growth opportunities that we expect will arise as housing supply and demand conditions in our served markets begin to stabilize.

KBnxt Operational Business Model. We began operating under the principles of our KBnxt operational business model in 1997. The KBnxt operational business model seeks to generate greater operating efficiencies and return on investment through a disciplined, fact-based and process-driven approach to homebuilding that is founded on a constant and systematic assessment of consumer preferences and market opportunities. The key principles of our KBnxt operational business model include:

- gaining a detailed understanding of consumer location and product preferences through regular surveys;
- managing our working capital and reducing our operating risks by acquiring developed and entitled land at reasonable prices in markets with high growth potential, and by disposing of land and interests in land that no longer meet our strategic or investment goals;
- using our knowledge of consumer preferences to design, construct and deliver the products homebuyers desire;
- in general, commencing construction of a home only after a purchase contract has been signed;
- building a backlog of net orders and reducing the time from initial construction to final delivery of homes to customers;
- establishing an even flow of production of high quality homes at the lowest possible cost; and
- offering customers affordable base prices and the opportunity to customize their homes through choice of location, floor plans and interior design options.

Our KBnxt operational business model is designed to help us achieve a leading position in our existing markets, expand our business into attractive new markets, exit investments that no longer meet our return standards or marketing strategy and calibrate our product lines to consumer preferences in both our existing and new markets. Historically, this focus has allowed us to achieve lower costs and economies of scale with respect to acquiring and developing land, purchasing building materials, subcontracting labor and providing options to customers.

Our expansion into new markets will depend on our assessment of a potential new market's viability and our ability to develop operations in that new market. We will also continue to consider appropriate acquisitions, as market conditions may produce attractive opportunities. However, expansion into new markets and large acquisitions are not a priority for us in the near term.

Strategic Objectives. Based on our KBnxt operational business model, and building on initiatives we implemented in 2006 and 2007 as conditions in our served markets became increasingly challenging, our primary strategic objectives include:

- Maintaining our balanced geographic footprint and focusing on growth opportunities in our existing served markets. We believe this will allow us to efficiently capitalize on the different rates at which our served markets are expected to stabilize. We also believe that our existing served markets offer the most attractive long-term growth prospects.

- Providing the best value and choice in homes and options for the first-time, first move-up and active adult homebuyer. By promoting value and choice through an affordable base price and product customization, we believe we can stand out from other homebuilders among our core customer base.

- Generating high levels of customer satisfaction and producing high quality homes. Achieving high customer satisfaction levels is a key driver to our long-term success and delivering quality homes is critical to achieving high customer satisfaction.

- Maintaining ownership and control over a three-to-four year supply of developable land. Keeping our inventory in line with our future sales expectations maximizes the use of our working capital, enhances our liquidity and helps maintain a strong balance sheet to support long-term strategic investments.

- Improving the affordability of our homes and lowering our production costs by redesigning and reengineering our products, building smaller homes, reducing production cycle times and direct construction costs, and targeting our pricing to median income levels in our served markets. We believe making our homes more affordable to our core customer base, with corresponding decreases in our production costs, will help us generate revenues and maintain our margins during the current housing market downturn and position us for longer-term profit growth.

- Continuing to align our cost structure with the expected size and growth of our business, generating free cash flow and maximizing the performance of our invested capital.

Marketing Strategy. Our marketing strategy aims to generate traffic to our communities by promoting our distinct customized homebuying experience. We believe this approach, supported with unique marketing partnerships and consistently applied companywide under one brand, generates a high perceived value for our products and our company among our target customers nationwide.

Reflecting this approach, in 2007 we launched a "Built to Order" consumer brand messaging initiative to provide potential homebuyers with a clearer understanding of how our homebuying experience differs from that of other homebuilders and resale homes. The "Built to Order" campaign emphasizes the choices our homebuyers can make in community location, floor plan, exterior architectural style, and interior design options and amenities to create a home built to their individual preferences. In highlighting the choices we make available to our homebuyers and reinforcing our general approach to build homes only after we receive a qualified order, the "Built to Order" campaign serves as the consumer face to core elements of our KBnxt operational business model.

During 2007, we also saw the expansion of our successful partnership with Martha Stewart, a leading lifestyle expert. Under this partnership, we offer our homebuyers in selected communities an opportunity to build homes inspired by Martha Stewart's own residences and to customize them using interior designs that reflect her style. We opened six additional Martha Stewart communities in 2007, bringing the total number to nine. The new Martha Stewart communities included the first in California, Texas, Colorado and Florida, as well as the second in North Carolina and Georgia. Our Martha Stewart communities have generated significant consumer and media interest and traffic, and we expect to open more of them in the future.

In September 2007, we announced a high-profile collaboration with The Walt Disney Company to develop exclusive Disney Home product options to be offered to our homebuyers. Options include elements that would normally be built into a home such as lighting fixtures and window coverings and feature some of Disney's most recognized characters. The first options in the collaboration will be available to our homebuyers in 2008.

During 2007, we also maintained our focus on the Internet as a key vehicle for reaching homebuyers. We redesigned our primary consumer website, kbhome.com, to be easier to navigate, to better reflect current technologies, and to make "Built to Order" a central message throughout the site.

We renewed our emphasis on the first-time, first move-up and active adult homebuyer in 2007. These homebuyers historically have been our core customers and are the buyers we anticipate to have the greatest potential for future home sales. In the present mortgage financing environment, focusing on these types of homebuyers also allows us to offer more homes that fall within conforming loan limits for Fannie Mae, Federal Home Loan Mortgage Corporation ("Freddie Mac"), Federal Housing Administration ("FHA") and Veterans Administration ("VA") programs.

In 2008, we will continue to implement our "Built to Order" marketing strategy, building on our efforts in 2007.

Sales Strategy. To ensure the consistency of our message and adherence to our KBnxt operational business model, sales of our homes are carried out by in-house teams of sales representatives. Our sales representatives are trained to provide prospective customers with floor plan and design choices, pricing information and tours of fully furnished and landscaped model homes that are decorated to emphasize the distinctive options we offer. We also have Countrywide KB Home Loans representatives available in many of our communities to assist prospective customers with financing questions.

To help our homebuyers customize their homes, we operate KB Home Studios in the vast majority of our markets. KB Home Studios are large showrooms where our customers may select from thousands of options to purchase conveniently as part of the original construction of their homes. The coordinated efforts of sales representatives, KB Home Studio consultants and other personnel involved in the customer's homebuying experience are intended to provide high levels of customer satisfaction and lead to enhanced customer retention and referrals.

Customer Service and Quality Control

Customer satisfaction is a high priority for us and we are committed to building and delivering quality homes. Our on-site construction supervisors perform regular pre-closing quality checks during the construction process to ensure our homes meet our quality standards and our homebuyers' expectations. We have customer service personnel who are responsible for responding to homebuyers' post-closing needs, including warranty claims. We believe prompt and courteous responses to homebuyers' needs throughout the homebuying process reduces post-closing repair costs, enhances our reputation for quality and service, and may help encourage repeat and referral business from homebuyers and the real estate community. Our goal is for our customers to be 100% satisfied with their new homes. We provide a limited warranty on all of our homes. The specific terms and conditions vary depending on the market where we do business. We generally provide a structural warranty of 10 years, a warranty on electrical, heating, cooling, plumbing and other building systems each varying from two to five years based on geographic market and state law, and a warranty of one year for other components of the home such as appliances.

Local Expertise

To maximize our KBnxt operational business model's effectiveness and help ensure its consistent execution, our employees are continuously trained on KBnxt operational principles and evaluated based on their achieving KBnxt operational objectives relevant to their particular job duties. We also believe that our business requires in-depth knowledge of local markets in order to acquire land in desirable locations and on favorable terms, to engage subcontractors, to plan communities based on local demand, to anticipate consumer tastes in specific markets and to assess the local regulatory environments. Accordingly, we operate through local divisions with local market expertise. We have experienced management teams in each of our divisions. Although we have centralized certain functions (such as marketing, advertising, legal, materials purchasing, product development, architecture and accounting) to benefit from economies of scale, our local management exercises considerable autonomy in identifying land acquisition opportunities, developing product and sales strategies, conducting product operations and controlling costs.

Community Development and Land Inventory Management

Our community development process generally consists of four phases: land acquisition, land development, home construction and sale. Historically, our community development process has ranged from six to 24 months in our

West Coast segment to a somewhat shorter duration in our other homebuilding segments. The length of the community development process varies based on, among other things, the extent of government approvals required, the overall size of the community, necessary site preparation activities, weather conditions and marketing results.

Although they vary significantly, our communities typically consist of 50 to 250 lots ranging in size from 2,000 to 20,000 square feet. Depending on the community, we offer from two to five model home designs with premium lots often containing more square footage, better views or location benefits. Our goal is to own or control enough lots to meet our forecasted production goals over the next three to four years.

Land Acquisition and Land Development. Our current focus is on creating a strong balance sheet and positioning ourselves for future growth. Significant land acquisitions are not currently a priority, but we will consider attractive opportunities as they arise. When we do acquire and develop land, we do so consistent with our KBnxt operational business model, which focuses on obtaining land containing fewer than 250 lots that are entitled and either physically developed (referred to as "finished lots") or partially finished. Acquiring finished or partially finished lots enables us to construct and deliver homes shortly after the land is acquired with minimal additional development expenditures. This is a more efficient way to use our working capital and reduces the operating risks associated with having to develop and/or entitle land, such as unforeseen improvement costs and/or changes in market conditions. However, depending on market conditions, we may acquire undeveloped and/or unentitled land. We expect that the overall balance of undeveloped, unentitled, entitled and finished lots in our inventory will vary over time.

Consistent with our KBnxt operational business model, we target geographic areas for potential land acquisitions and assess the viability of our current inventory based on the results of periodic surveys of both new and resale homebuyers in particular markets. Local, in-house land acquisition specialists conduct site selection research and analysis in targeted geographic areas to identify desirable land or to evaluate whether an existing interest we hold is consistent with our marketing strategy. We also use studies performed by third-party marketing specialists. Some of the factors we consider in evaluating land acquisition targets and assessing current inventory are: consumer preferences; general economic conditions; specific market conditions, with an emphasis on the prices of comparable new and resale homes in the market; expected sales rates; proximity to metropolitan areas and employment centers; population and commercial growth patterns; estimated costs of completing lot development; and environmental matters.

We generally structure our land purchases and development activities to minimize, or to defer the timing of cash and capital expenditures, which enhances returns associated with new land investments. While we use a variety of techniques to accomplish this, as further described below, we typically use agreements that give us an option right to purchase land at a future date at a fixed price for a small or no initial deposit payment. Our decision to exercise a particular option right is based on the results of due diligence we conduct after entering into an agreement. In some cases our decision to exercise an option may be conditioned on the land seller obtaining necessary entitlements, such as zoning rights and environmental approvals, and/or physically developing the land by a pre-determined date to allow us to build homes relatively quickly. Depending on the circumstances, our initial deposit payment for an option right may or may not be refundable to us if we do not purchase the underlying land.

In addition to acquiring land under option agreements, we may acquire land under agreements that condition our purchase obligation on our satisfaction with the feasibility of developing the land and selling homes on the land by a certain future date. Our option and other purchase agreements may also allow us to phase our land purchases and/or lot development over a period of time and/or upon the satisfaction of certain conditions. We may also acquire land with seller financing that is non-recourse to us, or by working in conjunction with third-party land developers. Our land option contracts generally do not contain provisions requiring our specific performance.

As previously noted, under our KBnxt operational business model, we generally attempt to minimize our land development costs by focusing on acquiring finished or partially finished lots. Where we purchase unentitled and unimproved land, we typically use option agreements as described above and during an applicable option period perform technical, environmental, engineering and entitlement feasibility studies, while we seek to obtain necessary governmental approvals and permits. These activities are sometimes done with the seller's assistance or at the seller's cost. The use of option arrangements in this context allows us to conduct these development-related activities while minimizing our inventory levels and overall financial commitments, including interest and other carrying costs. It also improves our ability to accurately estimate development costs, an important element in planning communities and pricing homes, prior to incurring them.

Before we commit to any land purchase or dispose of any interest in land we hold, our senior corporate management carefully evaluates each asset based on the results of our local specialists' due diligence and a set of strict financial measures, including, but not limited to, gross margin analyses and specific discounted, after-tax cash flow internal rate of return requirements. Potential land acquisition or disposal transactions are subject to review and approval by our corporate land committee, which is composed of senior corporate and regional management. The stringent criteria guiding our land acquisition and disposition decisions have resulted in our maintaining inventory in areas that we believe generally offer better returns for lower risk and lower cash and capital investment.

In light of difficult market conditions, we have sold some of our land and interests in land and have abandoned a portion of our options to acquire land. Consistent with our KBnxt operational business model, we determined that these sold or abandoned properties no longer met our strategic needs or our internal investment standards. If market conditions remain challenging, we may sell more of our land and interests in land, and we may abandon or try to sell our options to acquire land.

The following table shows the number of lots we owned in various stages of development and under option contracts in our homebuilding segments as of November 30, 2007 and 2006. The table does not include approximately 376 acres optioned as of November 30, 2007 and 393 acres optioned as of November 30, 2006 that have not yet been approved for subdivision into lots.

	Homes/Lots in Production		Land Under Development		Lots Under Option		Total Lots Owned or Under Option	
	2007	2006	2007	2006	2007	2006	2007	2006
West Coast	8,174	10,957	2,961	4,387	3,598	11,762	14,733	27,106
Southwest	7,059	9,773	2,866	2,338	5,743	11,101	15,668	23,212
Central	9,944	12,799	3,257	6,856	2,472	5,448	15,673	25,103
Southeast	7,916	10,576	2,888	6,034	8,830	19,436	19,634	36,046
Total	33,093	44,105	11,972	19,615	20,643	47,747	65,708	111,467

Reflecting our geographic diversity and balanced operations, as of November 30, 2007, 22% of the lots we owned or controlled were located in the West Coast reporting segment, 24% were in the Southwest reporting segment, 24% were in the Central reporting segment, and 30% were in the Southeast reporting segment.

The following table shows the dollar value of inventory we owned in various stages of development and under option contracts in our homebuilding segments as of November 30, 2007 and 2006 (in thousands):

	Homes/Lots in Production		Land Under Development		Lots Under Option		Total Lots Owned or Under Option	
	2007	2006	2007	2006	2007	2006	2007	2006
West Coast	$1,020,637	$1,794,320	$192,790	$ 432,103	$199,396	$454,720	$1,412,823	$2,681,143
Southwest	491,098	688,942	161,820	222,011	34,357	202,821	687,275	1,113,774
Central	420,811	531,048	59,802	119,649	53,248	85,808	533,861	736,505
Southeast	464,922	714,955	131,009	293,891	82,530	211,375	678,461	1,220,221
Total	$2,397,468	$3,729,265	$545,421	$1,067,654	$369,531	$954,724	$3,312,420	$5,751,643

Home Construction and Sale. Following the purchase of land and, if necessary, the completion of the entitlement process, we typically begin marketing homes and constructing model homes. The time required for construction of our homes depends on the weather, time of year, local labor supply, availability of materials and supplies and other factors. To minimize the costs and risks of standing inventory, we generally begin construction of a home only when we have contracted with a homebuyer. However, cancellations of home purchase contracts prior to the delivery of the underlying homes may cause us to have standing inventory of completed or partially completed homes.

We act as the general contractor for the majority of our communities and hire subcontractors for all production activities. The use of subcontractors enables us to reduce our investment in direct labor costs, equipment and facilities. Where practical, we use mass production techniques, and pre-made, standardized components and materials to

streamline the on-site production process. We have also developed systems for national and regional purchasing of certain building materials, appliances and other items to take advantage of economies of scale and to reduce costs through improved pricing and, where available, participation in manufacturers' rebate programs. At all stages of production, our administrative and on-site supervisory personnel coordinate the activities of subcontractors and subject their work to quality and cost controls. As part of our KBnxt operational business model, we have also emphasized even-flow production methods to enhance the quality of our homes, minimize production costs and improve the predictability of our revenues and earnings.

Backlog

We sell our homes under standard purchase contracts, which generally require a customer deposit at the time of signing. The amount of deposit required varies among markets and communities. Homebuyers are also generally required to pay additional deposits when they select options or upgrades for their homes. Most of our sales contracts stipulate that if a homebuyer cancels a contract with us, we have the right to retain the homebuyer's earnest money and option or upgrade deposits. However, we generally permit customers to cancel their obligations and obtain refunds of all or a portion of their deposit in the event mortgage financing cannot be obtained within a period of time, as specified in their contract.

"Backlog" consists of homes that are under contract but have not yet been delivered. Ending backlog represents the number of homes in backlog from the previous period plus the number of net orders (new orders for homes less cancellations) taken during the current period minus the number of homes delivered during the current period. The backlog at any given time will be affected by cancellations. In addition, deliveries of new homes typically increase from the first to the fourth quarter in any year.

Our backlog at November 30, 2007, excluding unconsolidated joint ventures, consisted of 6,322 homes, down 40% from the 10,575 homes in backlog at year-end 2006. Our backlog ratio was 68% for the fourth quarter of 2007 and 60% for the fourth quarter of 2006. (Backlog ratio is defined as homes delivered as a percentage of beginning backlog in the quarter.)

The significant decrease in backlog levels in 2007 reflected an overall decrease in net orders and lower average selling prices compared to prior years, reflecting the persistently challenging conditions in the housing market that began in 2006. Our net orders declined 13% to 19,490 in 2007 from 22,459 in 2006. Our average cancellation rate in 2007 was 42%, improving from an average of 47% in 2006. During the fourth quarter of 2007, our net orders decreased 32% from the fourth quarter of 2006, reflecting decreases in each of our reporting segments. The fourth quarter 2007 cancellation rate of 58% was the same as the cancellation rate we experienced in the year-earlier quarter, and 8 percentage points higher than the 50% cancellation rate we experienced in the third quarter of 2007.

The following table sets forth homes delivered, net orders and ending backlog for each quarter during the years ended November 30, 2007 and 2006:

	West Coast	Southwest	Central	Southeast	Total	Unconsolidated Joint Ventures
Homes delivered						
2007						
First	895	1,185	1,427	1,629	5,136	8
Second	950	1,061	1,236	1,529	4,776	11
Third	1,252	1,133	1,433	1,881	5,699	13
Fourth	1,860	1,476	2,214	2,582	8,132	95
Total	4,957	4,855	6,310	7,621	23,743	127
2006						
First	1,446	1,552	1,835	1,610	6,443	—
Second	1,579	1,813	2,183	1,827	7,402	—
Third	1,683	1,798	2,489	1,923	7,893	4
Fourth	2,505	1,848	3,106	2,927	10,386	—
Total	7,213	7,011	9,613	8,287	32,124	4
Net orders						
2007						
First	1,467	1,108	1,333	1,836	5,744	85
Second	1,673	1,437	1,903	2,252	7,265	109
Third	713	604	1,370	1,220	3,907	79
Fourth	679	482	660	753	2,574	9
Total	4,532	3,631	5,266	6,061	19,490	282
2006						
First	1,399	1,492	2,295	1,854	7,040	—
Second	1,628	1,239	2,723	1,899	7,489	—
Third	775	806	1,549	1,037	4,167	24
Fourth	772	576	1,156	1,259	3,763	34
Total	4,574	4,113	7,723	6,049	22,459	58
Ending backlog — homes						
2007						
First	2,187	2,453	2,961	3,582	11,183	131
Second	2,910	2,829	3,628	4,305	13,672	229
Third	2,371	2,300	3,565	3,644	11,880	295
Fourth	1,190	1,306	2,011	1,815	6,322	209
2006						
First	4,207	5,368	5,405	5,857	20,837	—
Second	4,256	4,794	5,945	5,929	20,924	—
Third	3,348	3,802	5,005	5,043	17,198	20
Fourth	1,615	2,530	3,055	3,375	10,575	54
Ending backlog — value, in thousands						
2007						
First	$1,054,825	$ 640,856	$494,429	$ 846,070	$3,036,180	$ 42,401
Second	1,357,973	733,211	633,775	1,012,098	3,737,057	84,773
Third	1,042,194	590,711	599,400	834,588	3,066,893	108,821
Fourth	466,726	313,120	312,952	406,037	1,498,835	80,523
2006						
First	$2,059,191	$1,690,266	$841,504	$1,455,301	$6,046,262	$ —
Second	2,200,413	1,473,792	947,562	1,499,091	6,120,858	—
Third	1,726,232	1,129,899	802,950	1,295,886	4,954,967	7,748
Fourth	819,795	708,206	487,223	811,533	2,826,757	20,292

Land and Raw Materials

We currently own or control enough land to meet our forecasted production goals for approximately the next three to four years, and we believe that we will be able to acquire land on acceptable terms for future communities as needed. In

fact, as discussed above, we have recently sold some of our land and abandoned options to purchase land in order to balance our holdings with diminished current and forecasted market conditions. In 2007, our land sales generated $189.0 million of revenues and $74.3 million of pretax losses, including $74.8 million of impairments. Our land option contract abandonments resulted in pretax, non-cash charges of $144.0 million in 2007.

The principal raw materials used in the construction of our homes are concrete and forest products. In addition, we use a variety of other construction materials in the homebuilding process, including sheetrock, plumbing and electrical items. We attempt to maintain efficient operations by using standardized materials that are commercially available on competitive terms from a variety of sources. In addition, our centralized or regionalized purchasing of certain building materials, appliances and fixtures allows us to benefit from large quantity purchase discounts and, in some cases, supplier rebates. When possible, we make bulk purchases of these products at favorable prices from suppliers and often instruct subcontractors to submit bids based on these prices.

Customer Financing

On-site representatives at our communities facilitate sales by offering to arrange financing for prospective customers through Countrywide KB Home Loans. Countrywide KB Home Loans is a retail mortgage banking joint venture that we established with Countrywide in 2005. Although our customers have the choice of obtaining financing elsewhere, we believe that the ability of Countrywide KB Home Loans to offer customers a variety of financing options on competitive terms as a part of the on-site sales process is an important factor in completing sales.

Countrywide KB Home Loans provides mortgage banking services to our homebuyers. Leveraging the resources of Countrywide, the joint venture operates with decentralized teams of employees located in all of our markets. Through its relationship with Countrywide, the joint venture offers virtually every loan program in the industry, as well as some products not offered by other lenders. This includes fixed and adjustable rate, conventional, privately-insured mortgages, FHA-insured or VA-guaranteed mortgages and mortgages funded by revenue bond programs of states and municipalities. Countrywide KB Home Loans originated loans for 72% of our customers who obtained mortgage financing in 2007 and 57% in 2006.

Discontinued Operations

In July 2007, we sold our 49% interest in our French operations. The disposition of the French operations enables us to invest additional resources in our U.S. homebuilding operations. The sale generated total gross proceeds of $807.2 million and a pretax gain of $706.7 million ($438.1 million net of income taxes). As a result of the sale, the French operations, which had previously been presented as a separate reporting segment, are presented as discontinued operations in our consolidated financial statements. All prior period information has been reclassified to be consistent with the current period presentation.

Employees

We employ a trained staff of land acquisition specialists, architects, planners, engineers, construction supervisors, marketing and sales personnel, and finance and accounting personnel, supplemented as necessary by outside consultants, who guide the development of our communities from their conception through the marketing and sale of completed homes.

At December 31, 2007, we had approximately 3,100 full-time employees in our operations, compared to approximately 5,100 at December 31, 2006. None of our employees are represented by a collective bargaining agreement.

Competition and Other Factors

We believe the use of our KBnxt operational business model, particularly the aspects that involve gaining a deeper understanding of customer interests and needs and offering a wide range of choices to homebuyers, provides us with long-term competitive advantages. The housing industry is highly competitive, and we compete with numerous homebuilders ranging from regional and national firms to small local builders primarily on the basis of price, location, financing, design, reputation, quality and amenities. In addition, we compete with housing alternatives other than new homes,

including resale homes and rental housing. In certain markets and at times when housing demand is high, we also compete with other builders to hire subcontractors.

Financing

We do not generally finance the development of our communities with project financing. By "project financing," we mean proceeds of loans specifically obtained for, or secured by, particular communities. Instead, our operations have been primarily funded by results of operations, public debt and equity financing, and borrowings under our unsecured revolving credit facility with various banks (the "Credit Facility").

Regulation and Environmental Matters

As part of our due diligence process for all land acquisitions, our policy is to use third-party environmental consultants to investigate for environmental risks and to require disclosure from land sellers of known environmental risks. Despite these precautions, there can be no assurance that we will avoid material liabilities relating to the removal of toxic wastes, site restoration, monitoring or other environmental matters affecting properties currently or previously owned by us. No estimate of any potential liabilities can be made although we may, from time to time, purchase property that requires modest environmental clean-up costs after appropriate due diligence. In such instances, we take steps prior to acquisition to gain assurance as to the precise scope of work required and the costs associated with removal, site restoration and/or monitoring, using detailed investigations performed by environmental consultants. To the extent contamination or other environmental issues have occurred in the past, we believe we may be able to recover restoration costs from third parties, such as the generators of hazardous waste, land sellers or others in the prior chain of title and/or insurers. Based on these practices, we anticipate that it is unlikely that environmental clean-up costs will have a material effect on our future consolidated financial position or results of operations. We have not been notified by any governmental agency of any claim that any of the properties owned or formerly owned by us are identified by the U.S. Environmental Protection Agency ("EPA") as being a "Superfund" clean-up site requiring remediation, which could have a material effect on our future consolidated financial position or results of operations. Costs associated with the use of environmental consultants are not material to our consolidated financial position or results of operations.

Access to Our Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). Our SEC filings are available to the public over the Internet at the SEC's website at http://www.sec.gov. The public may also read and copy any document we file at the SEC's public reference room located at 100 F Street N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room.

We encourage the public to read our periodic and current reports. Copies of these filings, as well as any future filings, may be obtained, at no cost, through our website http://www.kbhome.com or by writing to our investor relations department at investorrelations@kbhome.com or at our principal executive offices.

Item 1A. RISK FACTORS

In addition to the risks and the challenging market conditions previously mentioned, the following important factors could adversely impact our business. These factors could cause our actual results to differ materially from the forward-looking and other statements that we make in registration statements, periodic reports and other filings with the SEC, and that we make from time to time in our news releases, annual reports and other written communications, as well as oral forward-looking and other statements made from time to time by our representatives.

The homebuilding industry is experiencing a severe downturn that may continue for an indefinite period and adversely affect our business and results of operations compared to prior periods.

In 2007, many of our served markets and the U.S. homebuilding industry as a whole continued to experience a significant and sustained decrease in demand for new homes and an oversupply of new and existing homes available for sale, conditions that generally began in 2006. In many markets, a rapid increase in new and existing home prices in the years leading up to and including 2006 reduced housing affordability relative to consumer incomes and tempered buyer

demand. At the same time, investors and speculators reduced their purchasing activity and instead stepped up their efforts to sell residential property they had earlier acquired. These trends, which were more pronounced in markets that had experienced the greatest levels of price appreciation, resulted in overall fewer home sales, greater cancellations of home purchase agreements by buyers, higher inventories of unsold homes and the increased use by homebuilders, speculators, investors and others of discounts, incentives, price concessions and other marketing efforts to close home sales in 2007 compared to the past several years.

Reflecting these demand and supply trends, we, like many other homebuilders, experienced a large drop in net orders, a decline in the selling price of new homes sold and a reduction in our margins in 2007 relative to prior years. We can provide no assurances that the homebuilding market will improve in the near future. In fact, we expect the weakness to continue at least through 2008 and have an adverse effect on our business and our results of operations.

Our strategies in responding to the adverse conditions in the homebuilding industry have had limited success, and the continued implementation of these and other strategies may not be successful.

While we have been successful in generating positive operating cash flow and reducing our inventories in 2007, we have done so at significantly reduced gross profit levels and have incurred significant asset impairment charges. These contributed to the net loss we recognized in 2007. Also, in 2007, notwithstanding our sales strategies, we continued to experience an elevated rate of sales contract cancellations. We believe that the elevated cancellation rate largely reflects a decrease in homebuyer confidence, with continued price declines and increases in the level of sales incentives for both new and existing homes prompting homebuyers to forgo or delay home purchases. A more restrictive mortgage lending environment and the inability of some buyers to sell their existing homes have also led to cancellations. Many of the factors that affect new orders and cancellation rates are beyond our control. It is uncertain how long the reduced sales levels and the increased level of cancellations will continue.

Our business is cyclical and is significantly affected by changes in general and local economic conditions.

Our business can be substantially affected by adverse changes in general economic or business conditions that are outside of our control, including changes in:

- short- and long-term interest rates;
- the availability of financing for homebuyers;
- consumer confidence generally and the confidence of potential homebuyers in particular;
- federal mortgage financing programs and federal and state regulation of lending practices;
- federal and state income tax provisions, including provisions for the deduction of mortgage interest payments;
- housing demand from population growth and demographic changes, among other factors;
- the supply of available new or existing homes and other housing alternatives, such as apartments and other residential rental property;
- employment levels and job and personal income growth; and
- real estate taxes.

Adverse changes in these conditions may affect our business nationally or may be more prevalent or concentrated in particular regions or localities in which we operate. In 2007, adverse changes in many of these factors affected all of our markets, and we expect the widespread nature of the downturn in the housing market to continue at least through 2008. A downturn in the economy would likely exacerbate the adverse trends the housing market experienced in 2007.

Weather conditions and natural disasters, such as earthquakes, hurricanes, tornadoes, floods, droughts, fires and other environmental conditions, can also harm our homebuilding business on a local or regional basis. Civil unrest or acts of terrorism can also have an adverse effect on our business.

Fluctuating lumber prices and shortages, as well as shortages or price fluctuations in other building materials or commodities, can have an adverse effect on our business. Similarly, labor shortages or unrest among key trades, such as carpenters, roofers, electricians and plumbers, can delay the delivery of our homes and increase our costs.

The potential difficulties described above can cause demand and prices for our homes to diminish or cause us to take longer and incur more costs to build our homes. We may not be able to recover these increased costs by raising prices because of market conditions and because the price of each home is usually set several months before the home is delivered, as our customers typically sign their home purchase contracts before construction begins. The potential difficulties described above could cause some homebuyers to cancel or refuse to honor their home purchase contracts altogether. In fact, reflecting the difficult conditions in our served markets, we continued to experience elevated cancellation rates in 2007 and we may experience similar cancellation rates in 2008.

Supply shortages and other risks related to demand for building materials and/or skilled labor could increase costs and delay deliveries.

The homebuilding industry is highly competitive for skilled labor and building materials. Increased costs or shortages in building materials or skilled labor could cause increases in construction costs and construction delays. We generally are unable to pass on increases in construction costs to customers who have already entered into sales contracts, as the sales contracts generally fix the price of the home at the time the contract is signed, and may be signed well in advance of when construction commences. Sustained increases in construction costs may, over time, erode our margins, and pricing competition for materials and labor may restrict our ability to pass on any additional costs, thereby decreasing our margins.

Inflation may adversely affect us by increasing costs that we may not be able to recover, particularly if sales prices decrease.

Inflation can have a long-term impact on us because increasing costs of land, materials and labor may call for us to increase sales prices of homes in order to maintain satisfactory margins. However, if the current challenging and highly competitive conditions in the homebuilding market persist, we may be required to decrease prices in an attempt to stimulate sales volume. This potential lowering of sales prices, in addition to impacting our margins on new homes, may also reduce the value of our land inventory and make it more difficult for us to recover the full cost of previously purchased land in new home sales prices or, if we choose, in the disposition of land assets. In addition, depressed land values may cause us to forfeit deposits on land option contracts if we cannot satisfactorily renegotiate the purchase price of the optioned land. We may incur non-cash charges for inventory impairments or land option contract abandonments if the value of our inventory is so reduced or if we choose not to exercise land option contracts.

Reduced home sales may impair our ability to recoup development costs or force us to absorb additional costs.

We incur many costs even before we begin to build homes in a community. Depending on the stage of development, these include costs of preparing land and installing roads, sewage and other utilities, as well as taxes and other costs related to ownership of the land on which we plan to build homes. Reducing the rate at which we build homes extends the length of time it takes us to recover these costs. Also, we frequently acquire options to purchase land and make deposits that will be forfeited if we do not exercise the options within specified periods. Because of current market conditions, we have had to terminate some of these options, resulting in the forfeiture of deposits and unrecoverable development costs.

The value of the land and housing inventory we own or control may fall significantly and our profits may decrease.

The value of the land and housing inventory we currently own or control depends on market conditions, including estimates of future demand for, and the revenues that can be generated from, such inventory. The market value of our land inventory can vary considerably because there is often a significant amount of time between our initial acquisition of land and the delivery of homes on that land. The downturn in the housing market has caused the fair market value of certain of our inventory to fall, in some cases well below the estimated fair market value at the time we acquired it. Depending on our assessment of fair market value, we may need to write down the carrying value of certain of our inventory and take corresponding non-cash charges against our earnings to reflect the impaired value. We may also abandon our interests in certain land inventory that no longer meets our internal investment standards, which would also require us to take non-cash charges. If the current downturn in the housing market continues, we may need to take additional charges against

our earnings for abandonments or inventory impairments, or both. Any such non-cash charges would have an adverse effect on our consolidated results of operations.

If new home prices decline, interest rates increase or there is a downturn in the economy, some homebuyers may cancel their home purchases because the required deposits are small and generally refundable.

Our backlog numbers reflect the number of homes for which we have entered into a purchase contract with a customer but not yet delivered the home. Our home purchase contracts typically require only a small deposit, and in many states, the deposit is fully refundable at any time prior to closing. If the prices for new homes decline, competitors increase their use of sales incentives, interest rates increase, the availability of mortgage financing diminishes or there is a downturn in local or regional economies or the national economy, homebuyers may terminate their existing home purchase contracts with us in order to negotiate for a lower price or to explore other options. In 2007 and 2006, we experienced elevated cancellation rates, in part because of these reasons. Additional cancellations could have an adverse effect on our business and our results of operations.

Our long-term success depends on the availability of improved lots and undeveloped land that meet our land investment criteria.

The availability of finished and partially developed lots and undeveloped land for purchase that meet our internal investment criteria depends on a number of factors outside our control, including land availability in general, competition with other homebuilders and land buyers for desirable property, inflation in land prices, zoning, allowable housing density and other regulatory requirements. Should suitable lots or land become less available, the number of homes we may be able to build and sell could be reduced, and the cost of land could increase, perhaps substantially, which could adversely impact our results of operations.

Home prices and sales activity in the particular markets and regions in which we do business affect our results of operations because our business is concentrated in these markets.

Home prices and sales activity in some of our key markets have declined from time to time for market-specific reasons, including adverse weather, lack of affordability or economic contraction due to, among other things, the failure or decline of key industries and employers. If home prices or sales activity decline in one or more of the key markets in which we operate, particularly in Arizona, California, Florida, Nevada or Texas, our costs may not decline at all or at the same rate and, as a result, our overall results of operations may be adversely affected.

Market conditions in the mortgage lending and mortgage finance industries deteriorated significantly in 2007, which adversely affected the availability of credit for some purchasers of our homes, reduced the population of potential mortgage customers and reduced mortgage liquidity. Further tightening of mortgage lending or mortgage financing requirements or further reduced mortgage liquidity could adversely affect the availability of credit for some purchasers of our homes and thereby reduce our sales.

During 2007, the mortgage lending and mortgage finance industries experienced significant instability due to, among other things, defaults on subprime loans and a resulting decline in the market value of such loans. In light of these developments, lenders, investors, regulators and other third parties questioned the adequacy of lending standards and other credit requirements for several loan programs made available to borrowers in recent years. This has led to reduced investor demand for mortgage loans and mortgage-backed securities, tightened credit requirements, reduced liquidity, increased credit risk premiums and regulatory actions. Deterioration in credit quality among subprime and other nonconforming loans has caused most lenders to eliminate subprime mortgages and most other loan products that do not conform to Fannie Mae, Freddie Mac, FHA or VA standards. Fewer loan products and tighter loan qualifications in turn make it more difficult for some categories of borrowers to finance the purchase of our homes or the purchase of existing homes from potential move-up buyers who wish to purchase one of our homes. In general, these developments have resulted in a reduction in demand for the homes we sell and have delayed any general improvement in the housing market. Furthermore, they have resulted in a reduction in demand for the mortgage loans that we originate through Countrywide KB Home Loans, our joint venture with Countrywide. These reductions in demand have had, and are expected to continue to have, a materially adverse effect on our business and results of operations in 2008.

Many of our homebuyers obtain financing for their home purchases from Countrywide KB Home Loans. Countrywide provides the loan products that the joint venture offers to our homebuyers. If Countrywide refuses or is unable to make loan products available to the joint venture to provide to our homebuyers, our results of operations may be adversely affected.

Interest rate increases or changes in federal lending programs could lower demand for our homes.

Nearly all of our customers finance the purchase of their homes. In recent years, historically low interest rates and the increased availability of specialized mortgage products, including mortgage products requiring no or low down payments, and interest-only and adjustable rate mortgages, had made homebuying more affordable for a number of customers. Increases in interest rates or decreases in the availability of mortgage financing or of certain mortgage programs, as discussed above, may lead to higher down payment requirements or monthly mortgage costs, or both, and could therefore reduce demand for our homes.

Increased interest rates can also hinder our ability to realize our backlog because our home purchase contracts provide our customers with a financing contingency. Financing contingencies allow customers to cancel their home purchase contracts in the event they cannot arrange for financing.

Because the availability of Fannie Mae, Freddie Mac, FHA and VA mortgage financing is an important factor in marketing and selling many of our homes, any limitations or restrictions in the availability of such government-backed financing could reduce our home sales.

Tax law changes could make home ownership more expensive or less attractive.

Significant expenses of owning a home, including mortgage interest expense and real estate taxes, generally are deductible expenses for the purpose of calculating an individual's federal, and in some cases state, taxable income, subject to various limitations, under current tax law and policy. If the federal government or a state government changes income tax laws, as some policy makers have discussed recently, eliminating or substantially reducing these income tax deductions, the after-tax cost of owning a new home would increase substantially. This could adversely impact demand for and/or sales prices of new homes.

We are subject to substantial legal and regulatory requirements regarding the development of land, the homebuilding process and protection of the environment, which can cause us to suffer delays and incur costs associated with compliance and which can prohibit or restrict homebuilding activity in some regions or areas.

Our homebuilding business is heavily regulated and subject to an increasing amount of local, state and federal regulation concerning zoning, resource protection and other environmental impacts, building design, construction and similar matters. These regulations often provide broad discretion to governmental authorities that oversee these matters, which can result in unanticipated delays or increases in the cost of a specified project or a number of projects in particular markets. We may also experience periodic delays in homebuilding projects due to building moratoria in any of the areas in which we operate.

We are also subject to a variety of local, state and federal statutes, ordinances, rules and regulations concerning the environment. These laws and regulations may cause delays in construction and delivery of new homes, may cause us to incur substantial compliance and other costs, and can prohibit or severely restrict homebuilding activity in certain environmentally sensitive regions or areas. In addition, environmental laws may impose liability for the costs of removal or remediation of hazardous or toxic substances whether or not the developer or owner of the property knew of, or was responsible for, the presence of those substances. The presence of those substances on our properties may prevent us from selling our homes and we may also be liable, under applicable laws and regulations or lawsuits brought by private parties, for hazardous or toxic substances on properties and lots that we have sold in the past.

Further, a significant portion of our business is conducted in California, which is one of the most highly regulated and litigious states in the country. Therefore, our potential exposure to losses and expenses due to new laws, regulations or litigation may be greater than other homebuilders with a less significant California presence.

The mortgage banking operations of Countrywide KB Home Loans are heavily regulated and subject to the rules and regulations promulgated by a number of governmental and quasi-governmental agencies. There are a number of

federal and state statutes and regulations which, among other things, prohibit discrimination, establish underwriting guidelines that include obtaining inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts. A finding that we or Countrywide KB Home Loans materially violated any of the foregoing laws could have an adverse effect on our results of operations.

We are subject to a Consent Order that we entered into with the Federal Trade Commission in 1979 and related Consent Decrees that were entered into in 1991 and 2005. Pursuant to the Consent Order and the related Consent Decrees, we provide explicit warranties on the quality of our homes, follow certain guidelines in advertising and provide certain disclosures to prospective purchasers of our homes. A finding that we have significantly violated the Consent Order and/or the related Consent Decrees could result in substantial liabilities or penalties and could limit our ability to sell homes in certain markets.

Homebuilding and financial services are very competitive, and competitive conditions could adversely affect our business or our financial results.

The homebuilding industry is highly competitive. Homebuilders compete not only for homebuyers, but also for desirable land, financing, building materials, skilled management and trade labor. We compete in each of our served markets with other local, regional and national homebuilders, including those with a sales presence on the Internet, often within larger subdivisions containing portions designed, planned and developed by such homebuilders. These homebuilders may also have long-standing relationships with local labor, materials suppliers or land sellers, which may provide an advantage in their respective regions or local markets. We also compete with other housing alternatives, such as existing home sales and rental housing. The competitive conditions in the homebuilding industry can result in:

- fewer homes delivered;
- lower selling prices;
- our offering or increasing sales incentives, discounts or price concessions;
- lower profit margins;
- declining new home sales or increasing cancellations by homebuyers of their home purchase contracts with us;
- impairments in the value of our inventory, goodwill and other assets;
- difficulty in acquiring desirable land that meets our land buying criteria, and in selling our interests in land that no longer meet our investment return criteria on favorable terms;
- difficulty in acquiring raw materials and skilled management and labor at acceptable prices; or
- delays in construction of our homes.

Our financial services business competes with other mortgage lenders, including national, regional and local mortgage banks and other financial institutions. Mortgage lenders with greater access to capital or different lending criteria may be able to offer more attractive financing to potential customers.

When we are affected by these competitive conditions, our business and financial results can be adversely affected by decreased revenues, increased costs and/or diminished growth in our local or regional homebuilding business. In the current downturn in the homebuilding industry, the reactions of our competitors may be reducing the effectiveness of our efforts to achieve pricing stability and reduce our inventory levels.

Homebuilding is subject to warranty and liability claims in the ordinary course of business that can be significant.

In the ordinary course of our homebuilding business, we are subject to home warranty and construction defect claims. We record warranty and other reserves for the homes we sell based on historical experience in our markets and our judgment of the qualitative risks associated with the types of homes we build. We have, and require the majority of our subcontractors to have, general liability, property, errors and omissions, workers compensation and other business insurance. These insurance policies protect us against a portion of our risk of loss from claims, subject to certain self-insured retentions, deductibles, and other coverage limits. Through our captive insurance subsidiary, we reserve for costs to cover our self-

insured and deductible amounts under these policies and for any costs of claims and lawsuits, based on an analysis of our historical claims, which includes an estimate of claims incurred but not yet reported. Because of the uncertainties inherent to these matters, we cannot provide assurance that our insurance coverage, our subcontractor arrangements and our reserves will be adequate to address all our warranty and construction defect claims in the future. Additionally, the coverage offered by and the availability of general liability insurance for construction defects are currently limited and costly. There can be no assurance that coverage will not be further restricted and become more costly.

Because of the seasonal nature of our business, our quarterly operating results fluctuate.

We have experienced seasonal fluctuations in quarterly operating results. We typically do not commence significant construction on a home before a home purchase contract has been signed with a homebuyer. Historically, a significant percentage of our home purchase contracts are entered into in the spring and summer months, and a corresponding significant percentage of our deliveries occur in the fall and winter months. Construction of our homes typically requires approximately four months and weather delays that often occur in late winter and early spring may extend this period. As a result of these combined factors, we historically have experienced uneven quarterly results, with lower revenues and operating income generally during the first and second quarters of the year. However, the increasingly challenging market conditions we experienced in 2007 resulted in lower sales in the spring and summer months and correspondingly lower deliveries in the fall and winter months as compared to 2006. With the current difficult market conditions expected to continue through at least 2008, we can make no assurances that our normal seasonal patterns will occur in the near future.

Failure to comply with the covenants and conditions imposed by the agreements governing our indebtedness could restrict future borrowing or cause our debt to become immediately due and payable.

Our Credit Facility and the indentures governing our outstanding senior and senior subordinated public notes impose restrictions on our operations and activities. The most significant restrictions relate to limits on investments, cash dividends, stock repurchases and other restricted payments, incurrence of indebtedness, creation of liens and asset dispositions, and require maintenance of a maximum debt to equity (or leverage) ratio, a minimum interest coverage ratio, and a minimum level of tangible net worth. If we fail to comply with these restrictions or covenants, the holders of those debt instruments or the banks, as appropriate, could cause our debt to become due and payable prior to maturity or could demand that we compensate them for waiving instances of noncompliance. In addition, a default under the indenture for any of our notes or our Credit Facility could cause a default with respect to our other notes or the Credit Facility, as the case may be, and result in the acceleration of the maturity of all such defaulted indebtedness and our inability to borrow under the Credit Facility. Moreover, we may curtail our investment activities and other uses of cash to maintain compliance with these restrictions and covenants.

Our leverage may place burdens on our ability to comply with the terms of our indebtedness, may restrict our ability to operate and may prevent us from fulfilling our obligations.

The amount of our debt could have important consequences. For example, it could:

- limit our ability to obtain future financing for working capital, capital expenditures, acquisitions, debt service requirements or other requirements;
- require us to dedicate a substantial portion of our cash flow from operations to the payment of our debt and reduce our ability to use our cash flow for other purposes;
- impact our flexibility in planning for, or reacting to, changes in our business;
- place us at a competitive disadvantage because we have more debt than some of our competitors; and
- make us more vulnerable in the event of a downturn in our business or in general economic conditions.

Our ability to meet our debt service and other obligations will depend upon our future performance. Our business is substantially affected by changes in economic cycles. Our revenues, earnings and cash flows vary with the level of general economic activity and competition in the markets in which we operate. Our business could also be affected by financial, political and other factors, many of which are beyond our control. Changes in prevailing interest rates may also affect our ability to meet our debt service obligations because borrowings under our Credit Facility bear interest at floating rates. A higher interest rate on our debt could adversely affect our operating results.

Our business may not generate sufficient cash flow from operations and borrowings may not be available to us under our Credit Facility in an amount sufficient to pay our debt service obligations, fulfill financial or operational guarantees we have provided for certain unconsolidated joint venture transactions, or to fund our other liquidity needs. Should this occur, we may need to refinance all or a portion of our debt on or before maturity, which we may not be able to do on favorable terms or at all.

We may have difficulty in continuing to obtain the additional financing required to operate and develop our business.

Our homebuilding operations require significant amounts of cash and/or available credit. It is not possible to predict the future terms or availability of additional capital. Moreover, our outstanding public debt and the Credit Facility contain provisions that may restrict the amount and nature of debt we may incur in the future. The Credit Facility limits our ability to borrow additional funds by placing a maximum cap on our leverage ratio. Under the most restrictive of these provisions, at November 30, 2007, we would have been permitted to incur up to $3.56 billion of total consolidated indebtedness, as defined in the Credit Facility. This maximum amount exceeded our actual total consolidated indebtedness at November 30, 2007 by $2.68 billion. In addition, the Credit Facility limits our ability to borrow senior indebtedness, as defined in the Credit Facility, subject to a specified borrowing base. At November 30, 2007, we would have been permitted to incur up to $3.32 billion of senior indebtedness under the Credit Facility. This maximum amount exceeded our actual total senior indebtedness at November 30, 2007 by $1.66 billion. There can be no assurance that we can actually borrow up to these maximum amounts of total consolidated indebtedness or senior indebtedness at any time, as our ability to borrow additional funds, and to raise additional capital through other means, also depends on conditions in the capital markets and our credit worthiness. If conditions in the capital markets change significantly, it could reduce our ability to generate sales and may hinder our future growth and results of operations.

We are involved in government investigations and litigation relating to our past stock option grant practices.

The SEC and the U.S. Department of Justice ("DOJ") are conducting investigations into our stock option grant practices. In addition, shareholder derivative lawsuits have been filed in California state and federal courts relating to our stock option grant practices. It is possible that additional lawsuits may be filed. The investigations and lawsuits have resulted in, and will continue to result in, substantial legal and professional fees, and will continue to occupy our time and attention. An adverse outcome to the investigations or one or more of the lawsuits may have a negative effect on our business and our results of operations.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

We lease our corporate headquarters in Los Angeles, California. Our homebuilding division offices, except for our San Antonio, Texas office, and our KB Home Studios are located in leased space in the markets where we conduct business. Our homebuilding operations in San Antonio, Texas are principally conducted from premises that we own.

We believe that such properties, including the equipment located therein, are suitable and adequate to meet the requirements of our businesses.

Item 3. LEGAL PROCEEDINGS

Derivative Litigation

On July 10, 2006, a shareholder derivative action, *Wildt v. Karatz, et al.*, was filed in Los Angeles Superior Court. On August 8, 2006, a virtually identical shareholder derivative lawsuit, *Davidson v. Karatz, et al.*, was also filed in Los Angeles Superior Court. These actions, which ostensibly are brought on our behalf, allege, among other things, that defendants (various of our current and former directors and officers) breached their fiduciary duties to us by, among other things, backdating grants of stock options to various current and former executives in violation of our shareholder-approved stock option plans. Defendants have not yet responded to the complaints. On January 22, 2007, the Court entered an order, pursuant to an agreement among the parties and us, providing, among other things, that, to preserve the

status quo without prejudicing any party's substantive rights, our former Chairman and Chief Executive Officer shall not exercise any of his outstanding options, at any price, during the period in which the order is in effect. Pursuant to further stipulated orders, these terms remain in effect and are now scheduled to expire on February 1, 2008, unless otherwise agreed in writing. The plaintiffs have agreed to stay their cases while the parallel federal court derivative lawsuits discussed below are pursued. A stipulation and order effectuating the parties' agreement to stay the state court actions was entered by the court on February 7, 2007. The parties may extend the agreement that options will not be exercised by our former Chairman and Chief Executive Officer beyond the current February 1, 2008 expiration date.

On August 16, 2006, a shareholder derivative lawsuit, *Redfield v. Karatz, et al.*, was filed in the United States District Court for the Central District of California. On August 31, 2006, a virtually identical shareholder derivative lawsuit, *Staehr v. Karatz, et al.*, was also filed in the United States District Court for the Central District of California. These actions, which ostensibly are brought on our behalf, allege, among other things, that defendants (various of our current and former directors and officers) breached their fiduciary duties to us by, among other things, backdating grants of stock options to various current and former executives in violation of our shareholder-approved stock option plans. Unlike *Wildt* and *Davidson*, however, these lawsuits also include substantive claims under the federal securities laws. On January 9, 2007, plaintiffs filed a consolidated complaint. All defendants filed motions to dismiss the complaint on April 2, 2007. Subsequently, plaintiffs filed a motion for partial summary judgment against certain of the defendants. Pursuant to stipulated orders, the motions to dismiss and the motion for partial summary judgment have been taken off calendar to permit the parties to explore settlement via mediation. The latest order provides that unless otherwise agreed to by the parties or order by the court, the motions shall be back on calendar as of late March 2008. Discovery has not commenced.

Government Investigations

In August 2006, we announced that we had received an informal inquiry from the SEC relating to our stock option grant practices. In January 2007, we were informed that the SEC is conducting a formal investigation of this matter. The DOJ is also looking into these practices but has informed KB Home that it is not a target of this investigation. We have cooperated with these government agencies and intend to continue to do so.

ERISA Litigation

A complaint dated March 14, 2007 in an action brought under Section 502 of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1132, *Bagley et al., v. KB Home, et al.*, was filed in the United States District Court for the Central District of California. The action is brought against us, our directors, and certain of our current and former officers. Plaintiffs allege that they are bringing the action on behalf of all participants in the KB Home 401(k) Savings Plan (the "401(k) Plan"). Plaintiffs allege that the defendants breached fiduciary duties owed to members of the 401(k) Plan by virtue of issuing backdated option grants and failing to disclose this information to the 401(k) Plan participants. Plaintiffs claim that this conduct unjustly enriched certain defendants to the detriment of the 401(k) Plan and its participants, and caused the 401(k) Plan to invest in our securities at allegedly artificially inflated prices. The action purports to assert three causes of action for various alleged breaches of fiduciary duty. We have filed a motion to dismiss all claims alleged against us. The Court heard oral argument on the motion on November 19, 2007, after which the Court took the motion under submission. The Court has not yet ruled on the motion, and because of the pendency of the motion, no discovery has been taken in the action.

Storm Water Matter

In January 2003, we received a request for information from the EPA pursuant to Section 308 of the Clean Water Act. Several other public homebuilders have received similar requests. The request sought information about storm water pollution control program implementation at certain of our construction sites, and we provided information pursuant to the request. In May 2004, on behalf of the EPA, the DOJ tentatively asserted that certain regulatory requirements applicable to storm water discharges had been violated on certain occasions at certain of our construction sites, and civil penalties and injunctive relief might be warranted. The DOJ has also proposed certain steps it would expect us to take in the future relating to compliance with the EPA's requirements applicable to storm water discharges. We have defenses to the claims that have been asserted and are exploring with the EPA, DOJ and other homebuilders methods of resolving the matter. To resolve the matter, the DOJ will want us to pay civil penalties and sign a consent decree affecting our storm water pollution practices at construction sites.

Other Matters

We are also involved in litigation and governmental proceedings incidental to our business. These cases are in various procedural stages and, based on reports of counsel, we believe that provisions or reserves made for potential losses are adequate and any liabilities or costs arising out of currently pending litigation should not have a materially adverse effect on our consolidated financial position or results of operations.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of 2007 to a vote of security holders, through the solicitation of proxies or otherwise.